AMAZON COM INC
Form 4
February 19, 2014

FORM 4

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

OMB APPROVAL

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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
Reynolds Shelley

(Last) (First) (Middle)

P.O. BOX 81226

(Street)

SEATTLE, WA 98108-1226

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
AMAZON COM INC [AMZN]

3. Date of Earliest Transaction (Month/Day/Year)
02/15/2014

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Vice President

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock, par value $.01 per share	02/15/2014		M		442	A	$ 0	6,431	D	
Common Stock, par value $.01 per share	02/15/2014		M		962	A	$ 0	7,393	D	
Common Stock, par	02/18/2014		S (1)		5	D	$ 349.44	7,388	D	

value $.01 per share										
Common Stock, par value $.01 per share	02/18/2014		S (1)		200	D	$ 350.48 (2)	7,188	D	
Common Stock, par value $.01 per share	02/18/2014		S (1)		400	D	$ 351.93 (3)	6,788	D	
Common Stock, par value $.01 per share	02/18/2014		S (1)		399	D	$ 352.7226 (4)	6,389	D	
Common Stock, par value $.01 per share	02/18/2014		S (1)		300	D	$ 353.8533 (5)	6,089	D	
Common Stock, par value $.01 per share	02/18/2014		S (1)		100	D	$ 355.08	5,989	D	
Common Stock, par value $.01 per share								132.043	I	Held by the reporting person's Amazon.com 401(k) plan account

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)	5. Number of Derivative Securities	6. Date Exercisable and Expiration Date (Month/Day/Year)	7. Title and Amount of Underlying Securities (Instr. 3 and 4)

Derivative Security			Code	V	Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5) (A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares
Restricted Stock Unit Award	$ 0 (6)	02/15/2014	M			442	05/15/2010 (7)	02/15/2014	Common Stock, par value $.01 per share	442
Restricted Stock Unit Award	$ 0 (6)	02/15/2014	M			962	05/15/2012 (8)	02/15/2014	Common Stock, par value $.01 per share	962

Reporting Owners

Reporting Owner Name / Address	Relationships: Director	10% Owner	Officer	Other
Reynolds Shelley P.O. BOX 81226 SEATTLE, WA 98108-1226			Vice President	

Signatures

/s/ by Michael D. Deal as attorney-in-fact for Shelley Reynolds, Vice President	02/19/2014
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) This transaction was effected pursuant to a Rule 10b5-1 trading plan adopted by the reporting person.

(2) Represents the weighted average sale price. The highest price at which shares were sold was $350.51 and the lowest price at which shares were sold was $350.45.

(3) Represents the weighted average sale price. The highest price at which shares were sold was $352.38 and the lowest price at which shares were sold was $351.60.

(4) Represents the weighted average sale price. The highest price at which shares were sold was $352.77 and the lowest price at which shares were sold was $352.69.

(5) Represents the weighted average sale price. The highest price at which shares were sold was $354.03 and the lowest price at which shares were sold was $353.76.

(6) Converts into Common Stock on a one-for-one basis.

(7) This award vested based upon the following vesting schedule and the satisfaction of certain business criteria intended to qualify the award as tax-deductible compensation under Section 162(m) of the Internal Revenue Code: 158 shares on each of May 15, 2010, August 15, 2010, and November 15, 2010; 157 shares on February 15, 2011; 339 shares on each of May 15, 2011 and August 15, 2011; 338 shares on each of November 15, 2011 and February 15, 2012; 556 shares on each of May 15, 2012, August 15, 2012, and November 15, 2012; 555 shares on February 15, 2013; and 442 shares on each of May 15, 2013, August 15, 2013, November 15, 2013, and February 15, 2014.

(8) This award vested based upon the following vesting schedule and the satisfaction of certain business criteria intended to qualify the award as tax-deductible compensation under Section 162(m) of the Internal Revenue Code: 1,312 shares on each of May 15, 2012, August 15, 2012, and November 15, 2012; 1,313 shares on February 15, 2013; 963 shares on each of May 15, 2013, August 15, 2013, and November 15, 2013; and 962 shares on February 15, 2014.

Remarks:

REMARKS:

The reporting person undertakes to provide, upon request by the staff of the SEC, the issuer, or a security holder of the issuer,

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.

Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. round: transparent"> Our Products segment sells water dispensers that are designed to dispense Primo and other dispenser-compatible bottled water. Our Products sales are primarily generated through major U.S. retailers. Our water dispensers are sold primarily through a direct-import model, where we recognize revenues for the sale of the water dispensers when title is transferred to our retailer customers. We support retail sell-through with limited domestic inventory.

We evaluate the financial results of these segments focusing primarily on segment net sales and segment income (loss) from operations before depreciation and amortization (segment income (loss) from operations). We utilize segment net sales and segment income (loss) from operations because we believe they provide useful information for effectively allocating our resources between business segments, evaluating the health of our business segments based on metrics that management can actively influence and gauging our investments and our ability to service, incur or pay down debt.

Operating segments that do not meet quantitative thresholds for segment reporting are included in Other.

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Cost of sales for Exchange consists of costs for bottling and related packaging materials and distribution costs for our bottled water. Cost of sales for Products consists of contract manufacturing, freight, duties and warehousing costs of our water dispensers.

Selling, general and administrative expenses for both segments consist primarily of personnel costs for sales, marketing, operations support and customer service, as well as other supporting costs for operating each segment.

Expenses not specifically related to operating segments are shown separately as Corporate. Corporate expenses are comprised mainly of compensation and other related expenses for corporate support, information systems, and human resources and administration. Corporate expenses also include certain professional fees and expenses and compensation of our Board of Directors.

Recent Transactions

In December 2009, we completed the divestiture of our former subsidiary, Prima Bottled Water, Inc. (Prima), by distributing the stock in Prima to our existing stockholders on a pro rata basis based upon each such stockholder s proportionate ownership of our common stock, Series A preferred stock and Series C preferred stock on an as-converted basis. The assets, liabilities and results of operations of Prima are accounted for as discontinued operations. For 2007, 2008 and 2009, we recognized losses from discontinued operations of $1.9 million, $5.7 million and $3.7 million, respectively. For the six months ended June 30, 2009 and 2010, we recognized losses from discontinued operations of $0.4 million and $0, respectively.

On June 1, 2010 we entered into an asset purchase with Culligan to purchase the Culligan Refill Business. See Culligan Refill Acquisition on page 84 for a more detailed description of this transaction.

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Results of Operations

The following table sets forth our results of operations for the periods indicated:

	Years Ended December 31,			Six Months Ended June 30,	
	2007	2008	2009	2009	2010
				(Unaudited)	
			(In thousands)		
Consolidated statements of operations data:					
Net sales	$ 13,453	$ 34,647	$ 46,981	$ 24,500	$ 21,002
Operating costs and expenses:					
Cost of sales	11,969	30,776	38,771	20,368	16,672
Selling, general and administrative expenses	10,353	13,791	9,922	5,041	5,814
Depreciation and amortization	3,366	3,618	4,205	2,078	2,010
Total operating costs and expenses	25,688	48,185	52,898	27,487	24,496
Loss from operations	(12,235)	(13,538)	(5,917)	(2,987)	(3,494)
Interest (expense) and other income, net	65	(70)	(2,257)	(1,037)	(1,464)
Loss from continuing operations before income taxes	(12,170)	(13,608)	(8,174)	(4,024)	(4,958)
Provision for income taxes					
Loss from continuing operations	(12,170)	(13,608)	(8,174)	(4,024)	(4,958)
Loss from discontinued operations, net of income taxes	(1,904)	(5,738)	(3,650)	(357)	
Net loss	(14,074)	(19,346)	(11,824)	(4,381)	(4,958)
Preferred dividends and beneficial conversion charge	(2,147)	(19,875)	(3,042)	(1,521)	(1,164)
Net loss attributable to common stockholders	$ (16,221)	$ (39,221)	$ (14,866)	$ (5,902)	$ (6,122)

The following table sets forth our results of operations expressed as a percentage of net sales for the periods indicated:

	Years Ended December 31,			Six Months Ended June 30,	
	2007	2008	2009	2009	2010
				(Unaudited)	
Consolidated statements of operations data:					

Net sales	100.0%	100.0%	100.0%	100.0%	100.0%
Operating costs and expenses:					
Cost of sales	89.0	88.8	82.5	83.1	79.4
Selling, general and administrative expenses	77.0	39.8	21.1	20.6	27.6
Depreciation and amortization	25.0	10.5	9.0	8.5	9.6
Total operating costs and expenses	191.0	139.1	112.6	112.2	116.6
Loss from operations	(91.0)	(39.1)	(12.6)	(12.2)	(16.6)
Interest (expense) and other income, net	0.5	(0.2)	(4.8)	(4.2)	(7.0)
Loss from continuing operations before income taxes	(90.5)	(39.3)	(17.4)	(16.4)	(23.6)
Provision for income taxes					
Loss from continuing operations	(90.5)	(39.3)	(17.4)	(16.4)	(23.6)
Loss from discontinued operations, net of income taxes	(14.1)	(16.5)	(7.8)	(1.5)	
Net loss	(104.6)%	(55.8)%	(25.2)%	(17.9)%	(23.6)%

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The following table sets forth our segment net sales and segment income (loss) from operations presented on a segment basis and reconciled to our consolidated loss from operations.

	Years Ended December 31,			Six Months Ended June 30,	
	2007	2008	2009	2009	2010
				(Unaudited)	
			(In thousands)		
Segment Net Sales					
Exchange	$ 10,875	$ 19,237	$ 22,638	$ 11,121	$ 12,022
Products	949	13,758	22,824	12,642	8,177
Other	1,818	1,874	1,611	820	811
Inter-company elimination	(189)	(222)	(92)	(83)	(8)
Total net sales	$ 13,453	$ 34,647	$ 46,981	$ 24,500	$ 21,002
Segment Income (Loss) from Operations					
Exchange	$ (2,834)	$ (1,267)	$ 3,374	$ 1,517	$ 1,733
Products	(631)	(1,447)	(272)	60	26
Other	(175)	(116)	(34)	(30)	62
Inter-company elimination		(13)	9	5	(5)
Corporate	(5,229)	(7,077)	(4,789)	(2,461)	(3,300)
Depreciation and amortization	(3,366)	(3,618)	(4,205)	(2,078)	(2,010)
Loss from operations	$ (12,235)	$ (13,538)	$ (5,917)	$ (2,987)	$ (3,494)

Six Months Ended June 30, 2010 Compared to Six Months Ended June 30, 2009

Net Sales. Net sales for the six months ended June 30, 2010 decreased $3.5 million or 14.3% to $21.0 million from $24.5 million for the six months ended June 30, 2009. The decrease in sales for the six months ended June 30, 2010 resulted primarily from a 35.3% decrease in Products sales offset by an 8.1% increase in Exchange sales.

Exchange. Exchange net sales increased $0.9 million or 8.1% to $12.0 million, representing 57.2% of our total net sales, for the six months ended June 30, 2010. The increase for the six months ended June 30, 2010 compared to the same period in 2009 was the result of a 10.7% increase in water bottle units sold to approximately 2.1 million. The increase in units sold was driven by an 8.1% increase in selling locations to approximately 7,200 at June 30, 2010 as well as an increase in same store units of 4.0% for the six months ended June 30, 2010. The average price per unit decreased 2.4% for the six months ended June 30, 2010 compared to the same period in 2009. The decrease is a result of a shift in mix of transactions to 73.2% exchange transactions and 26.8% non-exchange transactions for the six months ended June 30, 2010 compared to 69.0% exchange transactions and 31.0% non-exchange transactions for the six months ended June 30, 2009. The shift in the mix of transactions is due to the increase in the overall number of repeat consumers utilizing our three- and five-gallon bottled water exchange service. This shift in mix is also impacted by the number of new locations added during the period. Locations in new markets generally have a higher percentage of non-exchange transactions as we introduce our service to new consumers. We recognize approximately twice as much revenue on non-exchange transactions as we do on exchange transactions as a result of the discount provided to consumers for the return of an empty three- or five-gallon bottle in exchange for the purchase of a new three- or five-gallon bottle of purified water. Adding new locations at which our water bottle exchange service is offered is important to our strategy of penetrating more homes with our water dispensers as expanded locations and increased water bottle availability enhance the convenience of our service to consumers.

Products. Products net sales decreased $4.5 million or 35.3% to $8.2 million, representing 38.9% of our total net sales, for the six months ended June 30, 2010. Dispenser sales decreased approximately 45,000 units or 24.6% to approximately 138,000 units for the six months ended June 30, 2010. We believe our water dispenser sales at retail to consumers increased substantially in units and revenues during 2010 based on sales data from our retail partners despite our reduced sales to retailers as we believe retailers are managing their inventory levels in anticipation of a new product line in the fourth quarter of 2010. In addition, our 2009 sales of water dispensers benefited from many of our retail customers building their inventory levels.

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Gross Margin. Our overall gross margin, defined as net sales less cost of sales, as a percentage of net sales increased to 20.6% for the six months ended June 30, 2010 from 16.9% for the six months ended June 30, 2009.

Exchange. Gross margin as a percentage of net sales in our Exchange segment increased to 26.9% for the six months ended June 30, 2010 from 25.4% for the six months ended June 30, 2009. This increase is due primarily to benefits from the improvements in our supply chain, which were completed in 2009. We anticipate that gross margins will continue to see improvements as we realize the full benefits of these improvements. These benefits could be offset slightly if fuel prices continue to increase and effect freight cost negatively.

Products. Gross margin as a percentage of net sales in our Products segment increased to 7.4% for the six months ended June 30, 2010 from 6.8% for the six months ended June 30, 2009. This increase is due primarily to the mix of dispensers sold during 2010 as compared to 2009. Our strategy is to sell our water dispensers at minimal operating profit in order to increase home penetration, which we believe will lead to increased recurring revenue, higher margin Exchange sales.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased $0.8 million or 15.3% to $5.8 million for the six months ended June 30, 2010. As a percentage of net sales, selling, general and administrative expenses increased to 27.6% for the six months ended June 30, 2010 from 20.6% for the six months ended June 30, 2009. The increase in selling, general and administrative expenses is primarily from increased salaries and related payroll costs associated with additional employees, professional and other expenses of approximately $0.3 million associated with the acquisition of Culligan Store Solutions, LLC and the increase in non-cash stock compensation of $0.1 million.

Exchange. Selling, general and administrative expenses of our Exchange segment increased $0.2 million or 14.3% to $1.5 million for six months ended June 30, 2010. Selling, general and administrative expenses as a percentage of Exchange segment net sales was 12.5% for the six months ended June 30, 2010 compared to 11.8% for the six months ended June 30, 2009. The increase resulted primarily from increased salaries and related payroll expenses from employees added in business development.

Products. Selling, general and administrative expenses of our Products segment decreased $0.2 million or 27.5% to $0.6 million for the six months ended June 30, 2010. This decrease is primarily the result of reduced advertising and marketing expenses in 2010 as compared to 2009. Selling, general and administrative expenses as a percentage of Products segment net sales increased to 7.1% for the six months ended June 30, 2010 from 6.3% for the six months ended June 30, 2009. The increase as a percentage of Products segment net sales is a result of the 35.3% decrease in Product net sales.

Other. Other selling, general and administrative expenses, which include our Other segment and Corporate, increased $0.8 million or 27.5% to $3.7 million for the six months ended June 30, 2010. Selling, general and administrative expenses as a percentage of consolidated net sales increased to 17.8% for the six months ended June 30, 2010 from 12.0% for the six months ended June 30, 2009. The increase resulted primarily from an increase in salaries and related payroll costs associated with the additional employees, professional and other expenses of approximately $0.3 million associated with the acquisition of Culligan Store Solutions, LLC and the increase in non-cash stock compensation of $0.1 million. In connection with the acquisition of Culligan Store Solutions, LLC we will incur a transaction fee of $1.5 million along with other legal and professional fees related to the acquisition that will be expensed when they are incurred. In addition, we expect to incur approximately $1.0 million annually in additional costs as a public company related to compliance, reporting and insurance.

Depreciation and Amortization. Depreciation and amortization decreased 3.3% to $2.0 million for the six months ended June 30, 2010.

Interest (Expense) and Other Income, Net. Net interest expense increased to $1.5 million for the six months ended June 30, 2010 from $1.0 million for the six months ended June 30, 2009. The increase is a result of an increase in the use of debt to fund business operations as well as the higher interest rate on our 2011 Notes.

Preferred Dividends and Beneficial Conversion Charge. Dividends on our Series B preferred stock decreased $0.4 million to $1.2 million for the six months ended June 30, 2010. In January 2009, we offered holders of our Series B preferred stock the option to suspend their current cash dividend payment of 10% in exchange for a

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dividend accrual of 15% for 2009. In January 2010, the dividend accrual was reduced to 10% with no cash dividend until the Series B preferred stock is redeemed. Cash dividends paid on our Series B preferred stock were $0.2 million and $0.8 million for the six months ended June 30, 2010 and 2009, respectively. At June 30, 2010, the accrued and unpaid dividends on our Series B preferred stock is $3.3 million, which is included in accrued expenses and other current liabilities in the consolidated balance sheet. In July 2010, we agreed to modify the terms of common stock warrants for the aggregate purchase of 716 shares of common stock, originally issued to the purchasers of the Series B preferred stock and Series C preferred stock, to remove a provision that accelerated the termination of the warrants exercise period upon the consummation of an IPO. The warrants will now expire on the date such warrants would have otherwise expired absent an IPO. At the time of the modification a charge of approximately $2.3 million will be recorded to additional paid in capital with no effect on total stockholders equity, but will increase the net loss attributable to common stockholders in the third quarter of 2010. In October 2010, we agreed to reduce the exercise price of the warrants issued to the holders of the Series C convertible preferred stock from $20.66 to $13.04. At the time of modification, a charge of approximately $0.2 million will be recorded to additional paid in capital with no effect on stockholders equity but will increase the net loss attributable to common stockholders in the fourth quarter of 2010.

Year Ended December 31, 2009 Compared to Year Ended December 31, 2008

Net Sales. Net sales for 2009 increased $12.3 million or 35.6% to $47.0 million from $34.6 million in 2008. The increase in sales resulted primarily from a 65.9% increase in Products sales and a 17.7% increase in Exchange sales.

Exchange. Exchange net sales increased $3.4 million or 17.7% to $22.6 million in 2009, representing 48.2% of our total net sales in 2009. The increase was due to an increase in water bottle units sold of approximately 0.6 million units or 19.8% to 3.9 million units sold in 2009. The increase in units sold was driven by a same store sales increase of 7.9% as well as an 8.3% increase in selling locations to approximately 7,000 at December 31, 2009. We believe the increase in same store sales is primarily a result of two factors: first, the increase in water dispenser sales results in an increasing number of consumers of three- and five-gallon bottled water and second, as more consumers become aware of and participate in our exchange program at a particular selling location, the number of water bottle units sold at that location typically increases over comparable prior periods. During 2009, we added approximately 600 selling locations as a result of both adding new retail customers and increased penetration with our existing retail customers. The average price per unit decreased 1.7% in 2009 compared to 2008 as a result of a shift in mix of transactions to 70.9% exchange and 29.1% non-exchange transactions in 2009 compared to 63.2% exchange and 36.8% non-exchange transactions in 2008. The shift in the mix of transactions is due to the increase in the overall number of repeat consumers utilizing our three- and five-gallon bottled water exchange service compared to the number of consumers that are new to our service. We anticipate the shift in mix towards a higher percentage of exchange transactions to continue as the overall number of consumers utilizing our exchange program continues to grow. We recognize approximately twice as much revenue on non-exchange transactions as we do on exchange transactions as a result of the discount provided to consumers for the return of an empty three- or five-gallon bottle in exchange for the purchase of a new three- or five-gallon bottle of purified water. Adding new locations at which our water bottle exchange service is offered is important to our strategy of penetrating more homes with our water dispensers as expanded locations and increased water bottle availability enhance the convenience of our service to consumers.

Products. Products net sales increased $9.1 million or 65.9% to $22.8 million in 2009, representing 48.6% of our total net sales in 2009. Dispenser sales increased 95,000 units or 53% to approximately 272,000 units in 2009. The increase in sales and units in 2009 is primarily a result of a greater than 100% increase in the number of retail locations offering our dispensers to approximately 5,500 at December 31, 2009. The difference in growth rates in net sales compared to the number of retail locations at which our water dispensers are offered is the result of retail locations being added during the course of the year which did not sell our water dispensers during the entire twelve-month period. As a result, during a period in which we experience rapid growth in the number of retail locations at which our water dispensers are offered, there is a delay before the full effect of these additional retail locations is reflected in our net sales. In addition, we successfully launched several new water dispenser models which accounted for approximately 48% of the total units sold in 2009. We anticipate continuing to introduce and offer

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new water dispenser models. Water dispenser home penetration is critical to the success of our strategy of increasing sales of our complementary recurring-revenue bottled water exchange service.

Gross Margin. Our overall gross margin, defined as net sales less cost of sales, as a percentage of net sales increased to 17.5% for 2009 from 11.2% for 2008.

Exchange. Gross margin as a percentage of net sales in our Exchange segment increased to 26.6% for 2009 from 15.2% in 2008 due primarily to decreased freight costs as a result of the addition of bottling and distribution capabilities during 2008 for which we received a full-year benefit in 2009. With these additions we believe we have sufficient bottling and distribution capabilities to service our continued growth. We anticipate slight improvements in gross margin for our Exchange segment for 2010 as we further benefit from improvements in our supply chain and realize efficiencies from our business model in which many of our variable costs are fixed.

Products. Gross margin as a percentage of net sales in our Products segment improved to 5.6% for 2009 from 0.5% in 2008 due primarily to improved pricing from retailers. Our strategy is to sell our water dispensers at minimal operating profit in order to increase home penetration, which we believe will lead to increased recurring-revenue, higher margin Exchange sales.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for 2009 decreased $3.9 million or 28.1% to $9.9 million from $13.8 million and, as a percentage of net sales, decreased to 21.1% for 2009 from 39.8% for 2008.

Exchange. Selling, general and administrative expenses of our Exchange segment decreased $1.5 million or 36.8% to $2.6 million from $4.2 million and as a percentage of Exchange segment net sales decreased to 11.7% in 2009 from 21.8% in 2008. The decrease is due to lower employee-related costs as a result of a reduction in headcount of seven employees as well as reduced levels of consulting fees and related travel and benefit costs resulting in approximately $1.0 million of the overall reduction of selling, general and administrative expenses. The additional personnel resources were related to our efforts in 2008 to expand our supply chain with more bottling and distribution capacity. During 2009 we were able to reduce these personnel resources when our supply chain reached what we believe to be an appropriate size. We were able to significantly grow our Exchange segment net sales and gross margins in 2009 despite the reduction in selling, general and administrative expenses.

Products. Selling, general and administrative expenses of our Products segment decreased as a percentage of Products segment net sales to 6.8% in 2009 from 11.1% in 2008. Our Products segment was able to significantly increase sales without the need for additional headcount or selling, general and administrative costs.

Other. Other selling, general and administrative expenses for 2009, which includes our Other segment and Corporate, decreased $2.4 million or 29.1% to $5.7 million from $8.1 million, and as a percent of consolidated net sales decreased to 12.2% for 2009 from 23.3% in 2008. The decrease is primarily due to lower employee-related costs as a result of a reduction in headcount of nine employees as well as reduced levels of consulting fees and related travel and benefit costs resulting in about $1.6 million of the overall reduction of selling, general and administrative expenses. The additional resources were related to our efforts in 2008 to expand our information system and financial infrastructure as well as our efforts to establish new business segments. While we do not expect to incur significant additional costs connected with the growth of our businesses in 2010, we do expect to incur about $1.0 million in additional costs as a public company related to compliance, reporting and insurance.

Depreciation and Amortization. Depreciation and amortization increased $0.6 million or 16.2% to $4.2 million in 2009 from $3.6 million in 2008. The increase is the result of a full year of depreciation on the $8.3 million of capital expenditures in 2008.

Interest (Expense) and Other Income, Net. Net interest expense for 2009 increased to $2.3 million from $70,000 in 2008 as a result of increased use of debt to fund business operations. We expect the proceeds from this offering to repay debt and lower future interest cost relative to that experienced during 2009.

Preferred Dividends and Beneficial Conversion Charge. Dividends on our Series B preferred stock increased $0.7 million to $3.0 million in 2009 from $2.3 million in 2008. In January 2009, we offered holders of our Series B preferred stock the option to suspend their current cash dividend payment of 10% in exchange for a dividend accrual of 15% for 2009. Cash dividends paid on our Series B preferred stock during 2009 and 2008 were $1.3 million and

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$2.3 million, respectively. At December 31, 2009 and 2008 the accrued and unpaid dividends on our Series B preferred stock were $2.4 million and $0.6 million, respectively, which is included in accrued expenses and other current liabilities in the consolidated balance sheet. Our Series C preferred stock is convertible into common stock at a ratio of 1:0.184, which was based upon a formula taking into account sales for 2008, compared to the original conversion ratio of 1:0.096. The change in the conversion resulted in a $17.6 million beneficial conversion or deemed dividend on the Series C preferred stock for 2008, which is included in the $19.9 million preferred dividends and beneficial conversion charge in 2008.

Year Ended December 31, 2008 Compared to Year Ended December 31, 2007

Net Sales. Net sales for 2008 increased $21.2 million or 157.5% to $34.6 million from $13.5 million in 2007. The increase in net sales resulted primarily from a 1,349.7% increase in Products sales and a 76.9% increase in Exchange sales.

Exchange. Exchange net sales increased $8.3 million to $19.2 million in 2008, representing 55.5% of our total net sales in 2008. The increase was due to an increase in water bottle units sold of 1.2 million or 61.2% to 3.2 million units sold in 2008. The increase in units was driven by a same store sales increase of 22.0% as well as a 36.1% increase in selling locations to approximately 6,400 selling locations at December 31, 2008. The average price per unit increased 9.7% in 2008 primarily as a result of a price increase implemented in mid-2008.

Products. Products net sales increased $12.8 million to $13.8 million, representing 39.7% of our total net sales in 2008. The increase is due to the successful launch of our Products business segment in late 2007. Product sales increased by approximately 165,000 units to approximately 177,000 units sold in 2008.

Gross Margin. Our overall gross margin, defined as net sales less cost of sales, as a percentage of net sales increased to 11.2% for 2008 from 11.0% for 2007.

Exchange. Gross margin as a percentage of net sales in our Exchange segment increased to 15.2% for 2008 from 6.1% in 2007 due primarily to decreased freight costs as a result of the addition of 28 bottlers and ten distributors in 2008.

Products. Gross margin as a percentage of net sales in our Products segment improved to 0.5% for 2008 from (23.2)% in 2007 due primarily to limited sales volume in 2007.

Selling, General and Administrative Expenses. Selling, general and administrative expenses, excluding impairment charges, for 2008 increased $3.4 million or 33.2% to $13.8 million from $10.4 million and, as a percentage of net sales, decreased to 39.8% for 2008 from 77.0% for 2007.

Exchange. Selling, general and administrative expenses of our Exchange segment increased $0.7 million or 19.5% to $4.2 million from $3.5 million and as a percentage of Exchange segment net sales decreased to 21.8% in 2008 from 32.2% in 2007. The increase is primarily due to higher employee-related costs as a result of headcount additions, consulting fees and related travel and benefit costs resulting in about $0.3 million of the overall increase. The additional personnel and resources were related to our efforts to expand our supply chain with more bottling and distribution capacity. Selling, general and administrative expenses as a percentage of Exchange segment net sales decreased significantly as we grew net sales at a faster rate than our expense growth.

Products. Selling, general and administrative expenses of our Products segment increased $1.1 million or 270.3% to $1.5 million from $0.4 million and as a percentage of Products segment net sales to 11.1% in 2008 from 43.3% in 2007. The increase is primarily due to increases in employee headcount resulting from our expanded product line and significant increase in net sales in 2008.

Other. Other selling, general and administrative expenses for 2008, which includes our Other segment and Corporate, increased $1.6 million or 24.5% to $8.1 million from $6.5 million, and as a percentage of consolidated net sales decreased to 23.3% for 2008 from 48.3% in 2007. The increase is primarily due to higher employee-related costs as a result of additional headcount, consulting fees and related travel and benefit costs related to our efforts in 2008 to expand our information system and financial infrastructure as well as our efforts to establish new business segments.

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Depreciation and Amortization. Depreciation and amortization increase $0.2 million or 7.5% to $3.6 million in 2008 from $3.4 million in 2007.

Interest Expense and Other Income, Net. Net interest and other income for 2008 decreased to an expense of $70,000 from income of $65,000 in 2007 as a result of the use of debt to fund business operations, which were primarily funded with equity in 2007.

Preferred Dividends and Beneficial Conversion Charge. Dividends on our Series B preferred stock increased $0.2 million to $2.3 million in 2008 from $2.1 million in 2007. At both December 31, 2008 and 2007, the accrued and unpaid dividends on our Series B preferred stock were $0.6 million, which is included in accrued expenses and other current liabilities in the consolidated balance sheet. Our Series C preferred stock is convertible into common stock at a ratio of 1:0.184, which was based upon a formula taking into account sales for 2008, compared to the original conversion ratio of 1:0.096. The change in the conversion resulted in a $17.6 million beneficial conversion or deemed dividend on the Series C preferred Stock for 2008, which is included in the $19.9 million of preferred dividends and beneficial conversion charge in 2008.

Liquidity and Capital Resources

The following table shows the components of our cash flows for the periods presented:

	Year Ended December 31,			**Six Months Ended June 30,**	
	2007	**2008**	**2009**	**2009**	**2010**
				(Unaudited)	
	(In thousands)				
Net cash provided by (used in):					
Operating activities	$ (6,752)	$ (11,832)	$ (1,972)	$ (2,426)	$ (4,558)
Investing activities	(4,992)	(9,628)	(2,450)	(1,345)	(1,712)
Financing activities	12,529	24,361	6,274	5,304	7,030

Since inception, we have financed our operations primarily through the sale of preferred stock, the issuance of long term debt and borrowings under credit facilities. At June 30, 2010, our principal sources of liquidity were accounts receivable, net of allowance for doubtful accounts, of $5.3 million compared to cash of $0.8 million and borrowing availability under our current senior revolving credit facility.

During the first half of 2010, our primary source of capital was proceeds from borrowings under our current senior revolving credit facility, which had a balance of $8.9 million at June 30, 2010. During 2009, the primary source of capital was proceeds from the issuance of long term debt and, as of December 31, 2009, we had an outstanding debt balance of $14.8 million, net of a $0.6 million discount. During 2008 and 2007, our primary source of capital was the proceeds of preferred stock issuances of $19.6 million and $14.1 million, respectively. Additionally, during 2008 we made borrowings under our current senior revolving credit facility, which had a balance of $7.0 million at December 31, 2008.

Net Cash Flows from Operating Activities

During the first half of 2010, we used $4.6 million in operations primarily as a result of $5.0 million of loss from continuing operations, offset by non-cash depreciation and amortization of $2.0 million. During the first half of 2009, we used $2.4 million in operating activities as a result of $4.0 million of loss from continued operations, offset by non-cash depreciation and amortization of $2.1 million.

Net cash used in operating activities was $2.0 million for 2009, $11.8 million for 2008 and $6.8 million for 2007. For 2009, net cash used in operations was primarily the result of $8.2 million of loss from continuing operations, partially offset by non-cash depreciation and amortization of $4.2 million, non-cash interest expense of $0.7 million related to our long term debt issuances and reduction in working capital components of $0.8 million. For 2008, net cash used in operations was primarily the result of $13.6 million of loss from continuing operations, partially offset by depreciation and amortization of $3.6 million. Additional working capital for accounts receivable and inventory due to revenue growth resulted in a use of cash of $1.9 million and $1.3 million, respectively, and was partially offset by an increase in accounts payable of $1.1 million.

For 2007, net cash used in operations was primarily the result of $12.2 million of loss from continuing operations, partially offset by depreciation and amortization of $3.4 million and the increase of accounts payable and accrued expenses of $1.0 million and $1.3 million, respectively.

Net Cash Flows from Investing Activities

Our primary investing activities are capital expenditures for property, equipment and bottles. Our capital expenditures in the past have been primarily for the installation of our recycle centers and display racks at new locations that offer our water bottle exchange service as well as related transportation racks and bottles. We also invest in technology infrastructure to manage our national network.

During the first half of 2010 and 2009, cash flows from investing activities primarily consisted of capital expenditures for property, equipment and bottles of $1.7 million and $1.3 million, respectively. During 2009, 2008 and 2007 cash flows from investing activities included capital expenditures for property and equipment and bottles of $2.4 million, $9.4 million and $5.0 million, respectively.

Net Cash Flows from Financing Activities

During the first half of 2010, cash provided by financing activities was primarily from borrowings under our current senior revolving credit facility of $8.5 million offset by dividends paid of $0.2 million and equity issuance costs of $1.4 million. During the first half of 2009, cash provided by financing activities was primarily from the issuance of long term debt of $10.0 million offset by payments on our current senior revolving credit facility of $3.0 million, debt issuance costs of $0.6 million and dividends paid of $0.8 million.

For 2009, financing activities were primarily the issuance of long term debt of $20.4 million that was partially offset by payments of $6.6 million on our current senior revolving credit facility, payments of $5.4 million related to other long term debt, Series B preferred stock dividend payments of $1.3 million and payment of debt issuance costs of $0.6 million. The cash component of our Series B preferred stock dividends was partially reduced in 2009 and accrued as opposed to paid currently. Additionally, the cash dividends paid will be further reduced for 2010 to approximately $0.2 million.

For 2008, financing activities were primarily the issuance of preferred stock of $19.6 million and borrowings of $7.0 million on our current senior revolving credit facility that were partially offset by payments of $2.3 million of Series B preferred stock dividends. For 2007, financing activities were primarily the issuance of preferred stock of $14.1 million that was partially offset by $1.6 million of Series B Preferred Stock dividend payments.

Current Senior Revolving Credit Facility

We originally entered into a revolving credit facility with Wachovia Bank National Association in June 2005 and have subsequently amended the facility and extended the term to January 30, 2011. The current facility commitment is $10.0 million, allows for up to a $3.0 million overadvance line (the Overadvance Line) and is subject to a customary borrowing base calculation for advances. Interest on the outstanding borrowings under the current senior revolving credit facility is payable quarterly at our option at: (i) the greater of (A) the LIBOR Market Index Rate or (B) 2.0% plus in either such case the applicable margin or (ii) the greater of (X) the Federal Funds Rate plus 0.50% or (Y) the bank s prime rate plus in either such case the applicable margin. At December 31, 2009 and 2008, the interest rate on the outstanding balance under the facility was at the bank s prime rate plus 2.50% and 0.75%, respectively (5.75% at

December 31, 2009 and 4.00% at December 31, 2008). Effective with a June 2010 amendment, the applicable margin was increased to 4.00% for a Libor Market Index Rate loan (5.00% when borrowings under the Overadvance Line are outstanding) and 2.00% for a loan provided at the Federal Funds Rate plus 0.50% or the bank s prime rate (3.00% when borrowings under the Overadvance Line are outstanding). At June 30, 2010, the interest rate on outstanding borrowings was 5.25% and availability under the facility was $0.9 million.

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We are required to pay a fee per annum equal to 3.50% of the outstanding amount of letters of credit issued under the current senior revolving credit facility. In addition, there is a fee of 0.50% on the unused portion of the revolver lending commitment. At June 30, 2010, there were outstanding letters of credit totaling approximately $0.2 million.

The current senior revolving credit facility contains various conditions for extensions of credit and restrictive covenants including minimum quarterly EBITDA and gross revenue requirements. Substantially all of our assets are pledged as collateral to borrowings under the current senior revolving credit facility.

Finally, Billy Prim, our Chief Executive Officer, has agreed to personally guarantee our borrowings with respect to the Overadvance Line in an amount up to $3.0 million. As an inducement to Mr. Prim to guarantee the $3.0 million Overadvance Line, the Company will issue Mr. Prim $150,000 of restricted stock with the per share value equal to (i) the initial public offering price or (ii) if the initial public offering does not occur, the lesser of (a) $12.84 per share (the fair value of our common stock based upon the valuation we obtained from a third party in December 2009) or (b) the price per share we issue equity in our next financing round. The restricted stock will be issued within 30 days after our initial public offering or the closing of our next financing round and will vest in full on January 2, 2011. The award of restricted stock was approved by the independent members of the board of directors and the amount of the award was based upon 5% of the guaranteed obligations (which the board members believed was an appropriate amount in light of their experience with similar transactions and representative of a 2.5% commitment fee and a 2.5% draw-down fee).

14% Subordinated Convertible Notes due March 31, 2011

In December 2009 and October 2010, we issued our 14% subordinated convertible notes due March 31, 2011 (2011 Notes) to 34 investors, including existing stockholders, affiliates of existing stockholders and senior management. The 2011 Notes have a total face value of $18.4 million and are subordinated to our current senior revolving credit facility. The 2011 Notes pay quarterly interest at a rate of 14% per annum. We intend to use proceeds of this offering to repay the 2011 Notes.

Warrants to purchase 130,747 shares of our common stock were issued in connection with the 2011 Notes. The initial fair value of the warrants is approximately $0.7 million and resulted in an original issue discount on the 2011 Notes which will be amortized as interest expense over the term of the 2011 Notes. The fair value of the warrants is included in other long-term liabilities in the consolidated balance sheet and will be adjusted periodically until such time as the exercise price becomes fixed at which time the then fair value will be reclassified as a component of stockholders equity (deficit).

New Senior Revolving Credit Facility

In connection with and as a condition to the closing of this offering and in order to partially finance the Culligan Refill Acquisition, we intend to enter into a new $40.0 million senior revolving credit facility with Wells Fargo Bank, National Association, Bank of America, N.A. and Branch Banking & Trust Company that will replace our current senior revolving credit facility. The new senior revolving credit facility will have a three-year term and will be secured by substantially all of the assets of the Company. The commitment letter related to this new senior revolving credit facility effectively limits our ability to borrow more than $20.0 million under this facility on the closing of the offering and the senior revolving credit facility. Interest on the outstanding borrowings under the new senior revolving credit facility will be payable at our option at either a floating base rate plus an interest rate spread or a floating rate of LIBOR plus an interest rate spread. We will also be required to pay a commitment fee on the unused amounts of the commitments under the new senior revolving credit facility. Both the interest rate spreads and the commitment fee rate are determined from a pricing grid based on the Company s total leverage ratio. The new senior revolving credit will contain the following financial covenants: (i) a maximum total leverage ratio that will initially be set at 3.5 to 1.0

and that will step down to 2.5 to 1.0 for the quarter ending December 31, 2011; (ii) a minimum EBITDA threshold initially set at $7.5 million for the quarter ended December 31, 2010 and increasing for the two quarters thereafter; and (iii) a minimum interest coverage ratio of 3.0 to 1.0 beginning with the quarter ended September 30, 2011.

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Adequacy of Capital Resources

Our future capital requirements may vary materially from those now anticipated and will depend on many factors, including acquisitions of other businesses, the rate of growth in new locations and related display and rack costs, cost to develop new water dispensers, sales and marketing resources needed to further penetrate our markets, the expansion of our operations in the United States and the response of competitors to our solutions and products. Historically, we have experienced increases in our capital expenditures consistent with the growth in our operations and personnel, and we anticipate that our expenditures will continue to increase as we grow our business.

While we had no material commitments for capital expenditures as of June 30, 2010, we do anticipate incurring between \$2.0 million and \$3.0 million of capital expenditures related to our anticipated growth in exchange locations and new water dispenser lines for the remainder of 2010. Upon completion of the Culligan Refill Acquisition, we estimate that we will incur between \$1.0 million and \$2.0 million of additional capital expenditures in 2010 related to current locations and future customer growth in connection with the Culligan Refill Business. In addition, we anticipate that we may incur additional expenses related to the integration of the Culligan Refill Acquisition.

In addition, following the completion of this offering, we expect to incur approximately \$1.0 million per year in increased costs as a public company related to compliance, reporting and insurance. Mitigating these additional expenses, our Series B preferred stock dividends will terminate upon the completion of this offering.

Following the completion of this offering (assuming an initial public offering price of \$12.00 per share) and our entering into our new senior revolving credit facility and the application of the proceeds therefrom as described herein (including consummation of the Culligan Refill Acquisition), we anticipate having \$5.0 million in initial availability under our new senior revolving credit facility. We anticipate this availability will increase to approximately \$13.0 million following the closing of this new facility. We believe our cash, the proceeds from this offering, funds available under our new senior revolving credit facility and future cash flows from our operations will be sufficient to meet our currently anticipated working capital and capital expenditure requirements for at least the next twelve months.

During the last three years, trends and conditions in the retail environment and credit markets, inflation and changing prices have not had a material effect on our business and we do not expect that these trends and conditions, inflation or changing prices will materially affect our business in the foreseeable future.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, investments in special purpose entities or undisclosed borrowings or debt. Additionally, we are not a party to any derivative contracts or synthetic leases.

Contractual and Commercial Commitment Summary

Our contractual obligations and commercial commitments as of December 31, 2009 are summarized below:

	Payments Due by Period				
Contractual Obligations[1]	**Total**	**Less Than 1 Year**	**1-3 Years**	**3-5 Years**	**More Than 5 Years**
			(In thousands)		

Long-term debt obligations	$ 15,000	$	$ 15,000	$	$
Capital lease obligations	7	4	3		
Operating lease obligations	2,008	691	841	394	82
Current senior revolving credit facility	423	423			
Total	$ 17,438	$ 1,118	$ 15,844	$ 394	$ 82

(1) No amounts are included herein with respect to dividends related to our Series B preferred stock as all such shares will be converted or redeemed in connection with this offering.

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Inflation

During the last three years, inflation and changing prices have not had a material effect on our business and we do not expect that inflation or changing prices will materially affect our business in the foreseeable future.

Quantitative and Qualitative Disclosures About Market Risk

For fixed rate debt, interest rate changes affect the fair value of financial instruments but do not impact earnings or cash flows. Conversely, for floating rate debt, interest rate changes generally do not affect the fair market value but do impact future earnings and cash flows, assuming other factors are held constant. The recorded carrying amounts of cash and cash equivalents approximate fair value due to their short maturities.

We are exposed to market risk related to changes in interest rates on borrowings under our current senior revolving credit facility. Our current senior revolving credit facility bears interest based on LIBOR and the prime rate, plus an applicable margin. To quantify our exposure to interest rate risk, a 100 basis point increase in interest rates would have increased interest expense for the years ended December 31, 2007, 2008, and 2009 by approximately $8,000, $29,000 and $132,000, respectively. Actual changes in interest rates may differ materially from the hypothetical assumptions used in computing this exposure.

Seasonality

We have experienced and expect to continue to experience seasonal fluctuations in our sales and operating income. Our sales and operating income have been highest in the spring and summer, and lowest in the fall and winter. Our Exchange segment, which generally enjoys higher margins than our Products segment, experiences higher sales and operating income in the spring and summer. Our Products segment had historically experienced higher sales and operating income in spring and summer, however, we believe the seasonality of this segment will be more dependent on retailer inventory management and purchasing cycles and not correlated to weather. Sustained periods of poor weather, particularly in the spring and summer, can negatively impact our sales in our higher margin Exchange segment. Accordingly, our results of operations in any quarter will not necessarily be indicative of the results that we may achieve for a fiscal year or any future quarter.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements and related notes, which have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). The preparation of our financial statements in conformity with GAAP requires us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions used to determine certain amounts that affect the financial statements are reasonable, based on information available at the time they are made. To the extent there are material differences between these estimates, judgments and assumptions and actual results, our consolidated financial statements may be affected. Some of the more significant estimates include allowances for doubtful accounts, valuation of inventories, depreciation, valuation of deferred taxes and allowance for sales returns.

Revenue Recognition. Revenue is recognized for the sale of three- and five-gallon purified bottled water upon either the delivery of inventory to the retail stores or the purchase by the consumer. Revenue is either recognized as an exchange transaction (where a discount is provided on the purchase of a three- or five-gallon bottle of purified water for the return of an empty three- or five-gallon bottle) or a non-exchange transaction. Revenues on exchange transactions are recognized net of the exchange discount. Our water dispensers are sold primarily through a direct-import model, where we recognize revenue when title is transferred to our retail customers. We have no contractual obligation to accept returns of water dispensers nor do we guarantee water dispenser sales. However, we will at times accept returns or issue credits for water dispensers that have manufacturer defects or that were damaged in transit. Revenues of water dispensers 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 consolidated statements of operations. Historically, these incentives have not been material to the overall consolidated results of operations. With the purchase of certain of our water dispensers we include a coupon for a free three- or five-gallon bottle of water. No revenue is recognized with respect to the

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redemption of the coupon for a free three- and five-gallon bottle of water and the estimated cost of the three- and five-gallon bottle of water is included in cost of sales.

Allowance for Doubtful Accounts. We maintain an allowance for doubtful accounts for estimated losses resulting from our retail customers inability to pay us. 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.

Long-Lived Assets. We review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset at the date it is tested for recoverability, whether in use or under development. An impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. We recorded an impairment charge in 2008 of $98,000, related to display racks no longer in use and to be disposed.

Income Taxes. We account for income taxes using the asset and liability method, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities, using enacted tax rates in effect for the year in which the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to the extent that utilization is not presently more likely than not.

Effective January 1, 2007, we adopted the provisions of Accounting Standards Codification (ASC) 740-10, *Income Taxes*. Previously, we had accounted for tax contingencies in accordance with ASC 450-10, *Contingencies*. As required by ASC 740-10, we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, we applied ASC 740-10 to all tax positions for which the statute of limitations remained open. The implementation of ASC 740-10 did not have a material impact on our consolidated financial statements.

Stock-Based Compensation. We account for our stock-based employee and director compensation plans in accordance with ASC 718, *Compensation-Stock Compensation*. ASC 718 requires recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements over the period the employee is required to perform the services in exchange for the award (presumptively the vesting period). In 2007, 2008 and 2009 compensation expense related to stock options was approximately $157,000, $215,000 and $298,000 and is included in selling, general and administrative expenses from continuing operations, respectively, and approximately $25,000, $61,000 and $80,000 is included in discontinued operations, respectively. For the six months ended June 30, 2010, compensation expense related to stock options was approximately $153,000, which is included in selling, general and administrative expenses from continuing operations.

We measure the fair value of each stock option grant at the date of grant using the Black-Scholes option pricing model. The weighted-average fair value per share of the options granted during 2007, 2008 and 2009 was $6.99, $8.66 and $5.11, respectively. The weighted-average fair value per share of the options granted during the six months ended June 30, 2010 was $6.16. The following assumptions were used in arriving at the fair value of options granted:

	Year Ended December 31,			Six Months Ended June 30,
	2007	**2008**	**2009**	**2010**
Risk-free interest rate	4.6%	3.2%	2.0%	2.8%
Expected life of options in years	6.3	5.9	5.5	6.3
Estimated volatility	45.0%	39.0%	39.0%	45.5%
Dividend yield				

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The risk-free interest rate is based on the implied yield available on U.S. Treasury zero-coupon issues with a remaining term approximately equal to the expected life of our stock options. The estimated pre-vesting forfeiture rate is based on our historical experience. The expected term of the options is based on evaluations of historical and expected future employee exercise behavior. As a non-public entity, historic volatility is not available for our shares. As a result, we estimated volatility based on a peer group of companies, which we believe collectively provide a reasonable basis for estimating volatility. We intend to continue to consistently use the same group of publicly traded peer companies to determine volatility in the future until sufficient information regarding volatility of our share price becomes available or the selected companies are no longer suitable for this purpose. We do not expect to declare dividends on our common stock in the foreseeable future. As of each stock option grant date, we considered the fair value of the underlying common stock, determined as described below, in order to establish the option exercise price.

During 2009 a total of 13,608 common stock options were granted, all on one date during the quarter ended March 31, 2009, at an exercise price of $13.04 per share. The estimated fair value of our common stock on the issuance date was $13.04 per share.

During the six months ended June 30, 2010, a total of 31,145 common stock options were granted, all in the first quarter of 2010, at an exercise price of $12.84 per share. The estimated fair value of our common stock on the issuance date was $12.84 per share. In addition, we granted 105,654 shares of restricted stock that generally cliff-vest over a three-year period and we recognized compensation expense of $127,000 related to these awards, which is included in selling, general, and administrative expenses from continuing operations.

At June 30, 2010, we had approximately 307,000 stock options outstanding, approximately 250,000 of which were vested with an intrinsic value of approximately $210,000, and approximately 57,000 of which were unvested with no intrinsic value. The intrinsic value reflects the amount by which $12.00 (the midpoint of our estimated public offering price) exceeds the exercise price of the outstanding stock options.

In April 2010, the Board of Directors approved the 100% vesting of all unvested stock option awards upon the successful completion of an initial public offering of the Company s common stock. All unrecognized compensation cost at the time the stock option awards become fully vested would then be expensed.

Significant Factors Used in Determining Fair Value of Our Common Stock. The fair value of the shares of common stock that underlie the stock options we have granted has historically been determined by our board of directors based upon information available to it at the time of grant. Because, prior to this offering, there has been no public market for our common stock, our board of directors has determined the fair value of our common stock by utilizing, among other things, recent or contemporaneous valuation information from negotiated equity transactions with third parties or third party valuations. The valuation information included reviews of our business and general economic, market and other conditions that could be reasonably evaluated at that time, including our financial results, business agreements, intellectual property and capital structure. These valuation approaches are based on a number of assumptions, including our future sales and industry, general economic, market and other conditions that could reasonably be evaluated at the time of the valuation.

For the 13,608 stock options granted on one date in the first quarter of 2009, the fair value of our common stock was determined by the board of directors to be $13.04 per share. The fair value was based in part upon the finalization of the conversion ratio of the Series C Preferred Stock on December 31, 2008. The Series C Preferred Stock was issued in an arms-length transaction primarily to unrelated third parties in 2008 with an initial conversion to common stock ratio of 1:0.096 or $25.04 per share. However, the Series C Preferred Stock contained a beneficial conversion feature that was negotiated with the primarily unrelated third parties that adjusted and was finalized based upon the consolidated net sales for the year ending December 31, 2008. The adjusted conversion ratio was 1:0.184 or $13.04 per share. In addition, the board of directors considered the Company s most recent independent valuation and then current expectations of the Company s future performance in determining that $13.04 per share was a reasonable fair valuation of common stock at December 31, 2008 and that there were not any significant changes in the business or results of operations from December 31, 2008 to the date in the first quarter of 2009 the stock options were issued that would change that estimated fair value.

For the 31,145 stock options and 105,654 restricted stock awards granted during the first quarter of 2010, the fair value of our common stock was determined by the board of directors to be $12.84 per share. The fair value was based upon a valuation obtained by the Company from an unrelated party in December 2009 that determined the fair value of the Company s common stock to be $12.84 per share. The fair value method utilized by the unrelated party was the income approach. The income approach recognizes that the current value is premised upon the expected receipt of future economic benefits or cash flows. The fair value is developed utilizing management s estimates of expected future cash flows and discounting them to their present value utilizing a discount rate of 20.0%. In addition, there were not any significant changes in the business, results of operations or expected future cash flows from the valuation date in December 2009 to the dates in the first quarter of 2010 the stock options and restricted stock awards were granted that would change the estimated fair value.

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance which established the Accounting Standards Codification (ASC or Codification) as the source of authoritative GAAP recognized by the FASB to be applied to nongovernmental entities, and rules and interpretive releases of the SEC as authoritative GAAP for SEC registrants. The Codification supersedes all existing non-SEC accounting and reporting standards upon its effective date and, subsequently, the FASB will not issue new standards in the form of Statements, FASB Staff Positions or Emerging Issues Task Force Abstracts. The guidance is not intended to change or alter existing GAAP. The guidance became effective in our fourth quarter of 2009. The guidance did not have an impact on our consolidated financial position, results of operations or cash flows.

In May 2009, the FASB issued authoritative guidance on the accounting for and disclosure of events that occur after the balance sheet date. This guidance was effective for interim and annual financial periods ending after June 15, 2009. This guidance was amended in February 2010. It requires an entity that is a SEC filer to evaluate subsequent events through the date that the financial statements are issued. The adoption did not impact our consolidated financial position, results of operations or cash flows.

In January 2010, the FASB issued guidance, which clarifies that the stock portion of a distribution to stockholders that allows them to receive cash or stock with a potential limitation on the total amount of cash that all stockholders can elect to receive in the aggregate is considered a share issuance that is reflected in earnings per share prospectively and is not a stock dividend. This update is effective for our first quarter of 2010. The adoption is not expected to have a material impact on our consolidated financial position results of operations or cash flows.

In January 2010, the FASB issued guidance that clarifies ASC 810 implementation issues relating to a decrease in ownership of a subsidiary that is a business or non-profit activity. This amendment affects entities that have previously adopted ASC 810-10. This update is effective for our first quarter of 2010. The adoption is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

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BUSINESS

Overview

We are a rapidly growing provider of three- and five-gallon purified bottled water and water dispensers sold through major retailers nationwide. 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 water. Our business is designed to generate recurring demand for Primo purified bottled water through the initial sale of our 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 where consumers receive a recycling ticket that offers a discount toward the purchase of a full bottle of Primo purified water. Each of our three- and five-gallon 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 an equivalent volume of single-serve bottled water. As of June 30, 2010, our water bottle exchange service and water dispensers were offered in each of the contiguous United States and located in approximately 7,200 and 5,500 retail locations respectively, including Lowe s Home Improvement, Sam s Club, Costco, Walmart, Target, Kroger, Albertsons and Walgreens.

We have created a new nationwide single-vendor water bottle exchange solution for our retail customers, addressing a market demand that we believe was previously unmet. Our water bottle exchange solution is easy for retailers to implement, requires minimal management supervision and store-based labor and provides centralized billing and detailed performance reports. Our solution offers retailers attractive financial margins and the ability to optimize typically unused retail space with our displays. Additionally, due to the recurring nature of water consumption and water bottle exchange, retailers benefit from year-round customer traffic and highly predictable revenue.

We deliver our solution to retailers utilizing our national network. Our independent bottlers and distributors typically have made already the capital investment required to deliver our solution, including investment in bottling facilities and storage and distribution assets. We focus our capital expenditures on developing new retail relationships, installing displays at store locations, raising brand awareness, research and development for new products and maintaining our MIS tools. We are able to manage our national network on a real-time basis through our MIS tools, which provide resource planning and delivery schedule tracking, thus enabling us to optimize our network s assets and respond to customer needs. In addition, our national network benefits from the recurring nature of water consumption and water bottle exchange that generates year-round demand and optimizes utilization of their existing production and distribution assets. In addition, our national network benefits from our MIS tools that assist resource planning and delivery schedule optimization. We believe our solution and national network provide us a significant competitive advantage in servicing our retail customers.

We benefit significantly from management experience gained over the last 15 years in exchange-based businesses, which enables us to implement best practices and develop and maintain key business relationships. Prior to founding Primo, our Chief Executive Officer founded Blue Rhino Corporation, a propane cylinder exchange business, in 1994 and, with several of our other key executive officers, led its initial public offering in 1998 and successful sale in 2004. At the time of the sale, we believe Blue Rhino was a market leader in propane grill cylinder exchange with over 29,000 retail locations in 49 states.

Industry Background

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

Emphasis on Health and Wellness

The majority of the human body is comprised of water and nearly all critical body functions rely on proper hydration. As part of a desire to live a healthier lifestyle, we believe consumers are increasingly focused on drinking more water relative to consumption of high caloric beverages, carbonated soft drinks and beverages containing artificial sweeteners.

Concerns Regarding Quality of Municipal Tap Water

Many consumers purchase purified water not only due to better taste, but also 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 additional contaminants to dissolve into the water through municipal or household pipes impacting taste and quality. There have been many recent publications highlighting pollution and quality issues with municipal water in the United States. Additionally, due to budgetary deficits, municipalities are increasingly privatizing their water treatment and distribution systems, and there have been many compliance and quality issues documented in connection with privatized municipal water systems.

Growing Preference for Purified Water

We believe consumer preference toward purified water relative to tap water continues to grow. With increasing availability in recent years, purified water has become accepted on a mainstream basis and preferred by many over municipal tap water. 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. Areas of concern include products packaging materials, carbon footprint and crude oil usage in production and distribution and the impact on landfills when disposed. Most single-serve PET water bottles are produced using fossil fuels and contribute to landfill waste given that only 27% of PET bottles are recycled according to a November 2009 Environmental Protection Agency report. Additionally, according to the December 2008 report, *Bottled Water-U.S.,* by Mintel International Group Limited, the incidence of people who do not drink single-serve PET bottled water because of environmental concerns nearly doubled from 18.0% in 2007 to 35.0% in 2008. 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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Source: National Association for PET Container Resources 2005 and 2008 Reports on Postconsumer PET Container Recycling Activity.

Availability of an Economical Water Bottle Exchange Service and Innovative Water Dispensers

According to 2007 United States census data, there are approximately 112 million households. Based on estimates derived from industry data, we believe the current household penetration rate of multi-gallon water dispensers is approximately 4%, with the vast majority of these households utilizing traditional home delivery services. Until recently, there has been little innovation, design enhancement and functionality improvement in water dispensers to meet modern household needs and competing water dispensers have traditionally retailed at prices we believe are unlikely to support greater household adoption. Compounding these issues, there previously was no viable provider of an economical water bottle exchange service with major retailer relationships nationwide to promote dispenser usage beyond the traditional home delivery model. We believe our water bottle exchange service provides this alternative and we believe we are currently the only provider delivering a solution nationally to retailers. 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, following the Culligan Refill Acquisition, refill vending services.

Our Competitive Strengths

We believe that our competitive strengths include the following:

Appeal to Consumer Preferences

Environmental Awareness. Our water bottle exchange service incorporates reuse of existing bottles, recycles water bottles when their lifecycle is complete and reduces landfill waste and fossil fuel usage compared to alternative methods of bottled water consumption. Our three- and five-gallon water bottles are exchanged, sanitized and reused up to 40 times before being taken out of service, crushed and recycled. Given its typical exchange lifecycle, one Primo five-gallon water bottle provides consumers with water in an amount equivalent to approximately 1,200 16 ounce single-serve PET bottles. When used as an alternative for consuming purified water, based on current recycling rates, one Primo five-gallon water bottle can prevent approximately 875 16 ounce single-serve PET bottles from contributing to landfill waste. In addition, we believe our water bottle exchange service uses less fossil fuel in the distribution process and has a lower carbon footprint than alternative methods of bottled water consumption. Our geographically dispersed national network is typically closer to major retailers than our centralized single-serve bottled water competitors. In addition, our exchange service is utilized by consumers as part of their ordinary shopping patterns, compared to separate, nonoptimized deliveries typically associated with traditional home delivery providers, generally by less fuel efficient vehicles.

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. We believe our five-gallon bottles of purified water typically cost a consumer between $5.99 and $6.99, after giving effect to the discount provided by our recycling ticket. We believe this compares favorably to the cost of single-serve PET bottles, case pack water and most home and office delivery services. The cost savings provided by our recycle ticket also provides consumers an incentive to remain a user of our water bottle exchange service. Finally, our water dispensers are sold at attractive retail prices in order to enhance consumer awareness and adoption of our water bottle exchange service, increase household penetration and drive sales of our bottled water.

Convenience. Our water bottle exchange service and water dispensers are available at major retail locations nationwide. In addition, our water bottle exchange service provides consumers the convenience of exchanging empty bottles and purchasing full bottles at any participating retailer. We offer three- and five-gallon water bottle options to address different consumer volume preferences. We believe our water bottle exchange service provides a convenient way to consume purified water compared to home and office delivery services. Our water bottle sales displays are fully stocked and ready for consumer purchases. In addition, our exchange service permits consumers to purchase only the number of water bottles they need without the water bottle purchase minimums or bottle deposits often charged by home and office delivery providers.

Taste. We have dedicated significant time and effort in developing our water purification process and formulating the proprietary blend of mineral ingredients included in Primo purified water that we believe has a silky smooth taste. In an independent taste test that we commissioned and was conducted in six regions throughout the United States in 2007, four out of five participants on average preferred Primo purified water over municipal tap water and three out of four participants on average preferred Primo purified water over their region s market-leading bottled water.

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 service is an effective option for their purified water consumption needs.

Key Retail Relationships Served by Nationwide Single-Vendor Solution

We believe we are the only water bottle exchange provider with a single-vendor solution for retailers nationwide. Our solution is easy to implement and supervise for national and regionally concentrated major retailers. We manage our national network to service our retail customers. This 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, national 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.

Ability to Attract and Retain Consumers

We offer razor-razorblade products designed to generate recurring demand for Primo purified bottled 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 Primo bottle of 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. Our water bottle exchange service is attractive to retailers as water dispenser owners consume what we believe to be an average of 35 multi-gallon bottles of water per year, which facilitates repeat consumer traffic in our retailers stores. In addition, based on discussions with our retail customers, we believe we are a leading provider of water dispensers to U.S. retailers, a status we believe we achieved within less than two years of entering the market. We believe this rapid success is due to the innovative features, design elements and attractive retail prices of our water dispensers. We further believe our offering high-quality water dispensers enhances consumer awareness and adoption of our water bottle exchange service, increases household penetration and drives sales of our bottled water.

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Efficient Business Model

Our business model allows us to efficiently offer our solution to our retail partners and centrally manage our national 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, our product quality, retailer inventory levels and the return of used bottles on a centralized basis, leveraging our invested capital and personnel. We own the bottles, transportation racks, mineral injectors and sales and recycling displays to ensure product quality and proper positioning of the Primo brand. We focus our capital expenditures on developing new retail relationships, installing displays at store locations, raising brand awareness, research and development for new products and maintaining our MIS tools. We believe our water bottle exchange service is unique in that we are not required to make a significant portion of the capital investment required to operate our exchange service nationwide. Participation in our water bottle exchange service does not typically require 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, the flow of payments between the retailer and our bottlers and independent distributors is a critical component of our overall relationship with our major retail accounts that we control efficiently through electronic data interchange.

Benefit from Management s Proven Track Record

We benefit greatly from management experience gained over the last 15 years in exchange businesses, which enables us to implement and refine best practices and develop and maintain key business relationships. Our Chief Executive Officer, Billy D. Prim, founded Blue Rhino Corporation, a propane cylinder exchange business, in 1994 and led its IPO in 1998 and its successful sale in 2004. At the time of the sale, we believe Blue Rhino was a market leader of propane grill cylinder exchange with over 29,000 retail locations in 49 states. In addition to our Chief Executive Officer, our Chief Financial Officer, Senior Vice President of Operations, Vice President of Products and Vice President of National Accounts all held comparable positions within the Blue Rhino organization during its rapid sales and location growth. We believe this experience combined with our nationwide single-vendor solution contributed to Walmart s recent decision to name Primo category manager for water bottle exchange and water dispensers.

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 June 30, 2010, our water bottle exchange service was offered at 5,600 of our top ten retailers nationwide locations. Such retailers present us an opportunity of approximately 13,900 additional nationwide locations.

There is minimal overlap of fewer than 100 locations where our water bottle exchange service is offered and the Culligan Refill Business is operated. Following the Culligan Refill Acquisition, we intend to further penetrate our other existing retail customers with our hydration solutions which collectively provide us the opportunity to be present in more than 26,600 additional locations.

Our long-term strategy includes targeting more than 50,000 total 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, drug stores and discount general merchandise stores for our water bottle exchange service or the Culligan Refill Business. 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.

Within two years of Primo s inception, we expanded our retail presence from 13 states to our current locations within each of the contiguous United States. In addition, from 2005 through June 30, 2010, we increased our water

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bottle exchange locations from approximately 300 to 7,200, representing a compound annual growth rate of approximately 103%.

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 bottle exchange service. We believe our water dispensers have appealing features, such as stainless steel finishes, adjustable hot and cold temperature controls and hidden bottle bottom-loading features for convenience. As a result of our strategy of developing innovative water dispensers, we believe based on discussions with our retail customers that we became a leading seller of water dispensers to retailers within less than two years of our entry into the market. Since we began selling our water dispensers in 2005, we have sold over 590,000 units, and have expanded our retail network from four locations as of December 31, 2007, to our current network of approximately 5,500 locations. We plan to continue introducing new dispenser models at attractive retail price points to meet the evolving needs of consumers, enhance consumer awareness and adoption of our water bottle exchange service, and increase household penetration. Our long term strategy is to provide multiple purified water-based beverages (including traditional hot drink products and flavored and carbonated beverages) from a single Primo water dispenser, with consistent promotion of our water bottle exchange and, following the Culligan Refill Acquisition, refill vending services to supply the purified water.

Increase Same Store Sales

We offer razor-razorblade products designed to generate recurring demand for Primo purified bottled water and, upon the consummation of the Culligan Refill Acquisition, drinking water refill vending services (the razorblade) through the initial sale of water dispensers (the razor). 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, following the Culligan Refill Acquisition, refill vending services.

We believe increasing unit sales of Primo purified bottled water is dependent on generating greater consumer awareness of the environmentally friendly and economical aspects of and the convenience associated with both our purified bottled water and our water bottle exchange and, following the Culligan Refill Acquisition, refill vending services. We expect that our branding, marketing and sales efforts will result in greater usage of our water bottle exchange and, following the Culligan Refill Acquisition, refill vending services. We are also increasing our public relations initiatives associated with new market launches, developing additional cooperative advertising programs with retail distribution partners and increasing our field marketing activities. In addition, as consumers exchange dispenser-compatible water bottles, we encourage the use of our water bottle exchange service by providing them a recycling ticket that provides a discount on a full bottle of Primo purified water.

Develop and Install Other Hydration Solutions

We believe we have significant opportunities to leverage our national 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. For example, the Culligan Refill Business will provide us an established platform to offer our retail partners self-service refill vending machines that dispense drinking water into empty reusable water bottles. We believe this offering will cater to a more price-sensitive consumer. In addition, we intend to offer to our retail partners automated, self-bagging purified ice dispensers. These purified ice dispensers will provide a simplified method of acquiring ice in customized offering sizes without the extensive manufacturing and storage networks typical of the ice dispensing industry.

Pursue Strategic Acquisitions to Augment Geographic and Retail Relationships

In addition to the Culligan Refill Acquisition, 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 companies.

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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 our purified water. 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. In an independent taste test that we commissioned and was conducted in six regions throughout the United States in 2007, four out of five participants on average preferred Primo purified bottled water over tap water and three out of four participants on average preferred Primo over their region s market-leading bottled water brand. We believe it is important that each bottle of Primo purified water has consistent taste and each production lot is tested by the bottler to ensure it meets our standards. In addition, to ensure that our safety standards are met and 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.

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.

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Water Dispensers

We currently source and market three lines of water dispensers comprised of 18 models:

Our dispensers are designed to dispense Primo and other dispenser-compatible bottled water. Our dispensers have manufacturer suggested retail prices that range from $169.99 for our top-of-the-line bottom-loading model with a stainless steel finish to $19.99 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. In addition, some of our dispenser models feature power switches to individually control the hot and cold tanks of the dispenser, saving additional energy when not in use and providing a child-safety feature. In addition, certain models of our bottom- and top-loading dispensers come equipped with adjustable hot and cold temperature controls conveniently located on the top of the dispenser.

We believe our bottom loading dispensers are attractive to consumers and will drive the greatest increase in household penetration as a result of their innovative styling and features. Water bottles are loaded and concealed inside our bottom-loading dispensers by a hinged door for ease of use and a clean aesthetic appearance.

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.

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. Our marketing efforts include the following initiatives:

Primo Water Packaging

Our three- and five-gallon water bottles, sales and recycling center displays, water dispensers and certain distributor delivery vehicles prominently display our Primo logo and distinctive four-bubble design.

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Primo Water Displays

Our sales and recycling center displays are typically located near the front of a store, providing point-of-sale advertising and branding. We believe our displays enhance consumer awareness of the Primo brand and reinforce the association of our water with an environmentally friendly, economical, convenient and healthy solution for purified water consumption. Our displays include Primo graphics, slogans and instructions on the exchange process that simply attach to the displays. We have the ability to quickly replace, customize or introduce new marketing materials on our displays throughout our retail network. In addition, we work with retailers to customize in-store solutions to best promote our brand.

Promotions

Our promotional activities target new customers by:

- Accepting third-party dispenser-compatible water bottles in the exchange process (which we believe is unique in the industry);
- Providing attractive pricing on our water dispensers;
- Offering a free bottle of water with the purchase of a water dispenser;
- Advertising in retailers weekly circulars; and
- Providing samples of our purified water and water dispensers on-site at our retailers locations and educating consumers on the benefits of our purified bottled water and dispensers.

We promote our brand through social media, our website (*www.primowater.com*) and other public relations efforts. We also maintain a blog (*www.breakfree411.com*) that is styled as a third-party website and provides updates on the water industry. In addition, we seek to raise awareness of our brand and products through blogs and related periodicals that target women as well as household and kitchen matters. We believe that women often significantly influence household and kitchen appliance decisions and concentrating our efforts in this manner is designed to improve the effectiveness of our advertising campaigns and improve household penetration.

Our promotional activities have evolved from our Taste Perfection campaign to our Zero Waste. Perfect Taste, campaign emphasizing our environmental efforts while simultaneously focusing on the taste of our purified water. We plan to increase our promotional activity as we expand our business.

The Primo Water Bottle Exchange 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. A bottle is filled with Primo purified water only after the inspection and sanitization steps outlined below are completed. 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. In comparison, municipal water is generally treated at a centralized processing facility and then distributed throughout the pipeline network. As the water flows to the point of use, contaminants and other foreign objects may be dissolved into the water, and household piping and faucets may collect sediment that over time reduces the quality of municipally supplied water.

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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 remove particles. 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.

Distribution Network

We rely on our national network to deliver our solution to retailers. Our water bottle exchange process begins when a distributor is directed through our proprietary MIS tool, Routeview, to stock or replenish a Primo bottled water retail location. Routeview 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 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.

*** Certain independent distributors operate multiple distribution sites and the Company-owned distribution sites in North Carolina and Virginia are part of a single Company-owned distribution operation.

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.

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. Our distributors are responsible for handling distribution and servicing our sales and recycling center displays. Through our handheld devices, distributors report their deliveries which are received by our systems and verified by data integrity checks. Depending on the retailer, our distributors either present the store manager with an invoice for the bottles delivered or our systems electronically bill the retailer. We believe our five-gallon bottles of purified water typically cost a consumer between $5.99 and $6.99, after giving effect to the discount provided by our recycling ticket. When accounting for the wholesale costs of our water, we believe our retailers receive a gross margin typically between 20% and 30%. We compensate our distributors with a fixed payment per delivered water bottle on the fifteenth day of the month following the delivery activity. Our fixed payment is a gross amount from which the distributor must typically pay the bottler. In order to maximize their returns and profitability, our distributors increasingly are becoming vertically integrated, using their capital to build bottling facilities. 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 cost.

We focus our capital expenditures on developing new retail relationships, installing displays at store locations, raising brand awareness, research and development for new products and maintaining our MIS tools. We are also

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responsible for the centralized operations and personnel, sales and recycling displays, bottles, transportation racks, mineral packets and mineral injectors and handheld devices. Our national network typically has made the capital investment required to operate our exchange service nationwide, 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 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.

Flow of Payments and Capital Requirements

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
Grocery Stores	Kroger, Albertsons, Food Lion
Membership Warehouses	Sam s Club, Costco
Drug Stores	Walgreens, CVS

In addition to the retail categories listed above, we anticipate entering the office retail category in the fourth quarter of 2010.

Retailer Opportunity

We offer retailers a single-vendor solution. Our water bottle exchange service provides retailers with a year-round consumer product and an opportunity to increase sales and profits with minimal labor and financial investment. Through our national network, we are able to service major retailers nationwide. Retailers benefit from our water bottle exchange service that offers high margin and generates productivity from often underutilized interior and exterior retail space. In addition, our water bottle exchange service has the potential to increase retailers sales of ancillary products through increased traffic from repeat water bottle exchange consumers, who we believe purchase an average of 35 water bottles annually.

Account Set-Up

We actively pursue headquarters-based retail relationships to better serve our retail partners and minimize layers of approval and decision-making with regard to the roll-out of our water bottle exchange service to multiple

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locations. Upon confirmation of new retail locations, we coordinate with the retailer and distributor to schedule openings in a timely manner. We actively assist retailers in developing site plans for the setup of our sales and recycling center displays. While retailer setup preferences may vary, retailers often like to locate the recycling center display prominently on the exterior of their store to ease the transaction process, showcase their recycling and environmental efforts and conserve inside floor space while at the same time promoting the Primo brand.

Account Service

Our water bottle exchange service is a turn-key program for retailers in which we and our distributors actively service each retail account. After the retail location is established, our distributors complete on-site training and have an economic interest in supporting and growing the business relationship to increase product throughput. Distributors deliver three- and five-gallon Primo bottled water directly to retail locations and maintain the sales and recycling center displays.

Sales Support

While distributors service our retail accounts, the customer relationship is owned and maintained by our experienced retail sales organization, which allows us to develop strong brand affinity and maintain key headquarters-based relationships to secure and maintain our national retail network. Our retail relationships are divided into regions and managed by our sales personnel. In addition, we leverage our independent distributors who typically employ their own sales representatives. This combined team is responsible for selling and supporting our water bottle exchange service to targeted retailers.

Systems Support

We supply each major retail customer with a customized sales and business update on a monthly basis. The monthly update consists of a graphical dashboard highlighting sales trends and location-based information as well as qualitative commentary to assist store and headquarters personnel in their business decisions. We believe our reports help retail personnel monitor the success of our water bottle exchange service and highlight our analytical and customer support capabilities as a retail partner. In many cases, our retail customers do not have internal reporting capabilities to develop comparable analyses.

Customer Service

We maintain a single toll-free number for all distributors, retailers and customers to contact us directly with questions regarding our bottled water, water bottle exchange process and customer service inquires. In addition, we maintain a separate toll-free number for our water dispensers. We believe maintaining our own customer service numbers allows us to effectively monitor all aspects of our business and receive feedback on issues first-hand that we can direct to our distributors or dispenser suppliers.

Significant Customers

For the year ended December 31, 2009, Lowe s Home Improvement, Sam s Club and Walmart represented approximately 33%, 19% and 15% of our total sales, respectively.

National Bottler and Distributor Network

In an effort to build a market-leading single-vendor national water bottle exchange service, we have sought to attract experienced and well-capitalized independent bottlers and distributors to support our retail partners. As of

December 31, 2009, we had 55 independent bottlers and 27 independent distributors as well as our two Company-owned distribution operations covering portions of four states.

Bottler and Distributor Opportunity

We provide independent bottlers and distributors with an attractive business opportunity, complementing many of their existing operations. We continually pursue new relationships and additional locations with existing retail

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partners to increase the production at each bottler s manufacturing facility and the retail customer density within each distributor s territory.

Bottler and Distributor Standards

We work very closely with our national network to ensure their production and storage standards meet or exceed the requirements of the United States Food and Drug Administration and other industry regulations. As we seek to promote our brand, we believe it is critical to provide bottled water that has consistent taste and is produced in a manner that exceeds current industry requirements. We regularly monitor, test and arrange for third-party hygiene audits of each bottling facility.

In addition, we regularly monitor our distributors performance to ensure a high level of account service. Distributors are generally required to develop an infrastructure sufficient to:

Complete customer installations within 30 days of the notification of a newly established account;
Monitor and maintain inventory levels with assigned retail accounts; and
Resolve water bottle stock-outs within 36 hours.

Bottler and Distributor Selection Process

We have selectively identified and pursued high quality independent bottlers and distributors that can support our major retailers nationwide. We screen all independent bottler and distributor candidates by reviewing credit reports, safety records and manufacturing compliance reports, and conducting management reference checks. As a result of this thorough selection process, we have established what we believe to be highly dependable relationships with our independent bottlers and distributors. We currently maintain three distributor or bottler relationships that have relatively high customer concentrations in the geographic areas they serve. None of these independent distributors or bottlers, however, had responsibility for more than 8.0% of the bottling or more than 12.6% of the distribution with respect to our water bottle exchange volume for the year ended December 31, 2009. We believe we have a positive relationship with each of these parties and our senior executives have maintained a business relationship with each such party since they were managing operations at Blue Rhino Corporation.

Bottler and Distributor Services

We currently employ raw material procurement and supply chain personnel who perform periodic inventory audits and month-end review procedures. In addition we have operations personnel who manage our independent bottler and distributor relationships, including training and monitoring personnel and activities. We also employ customer service personnel who handle bottler, distributor, retailer and end-user phone calls.

Company Owned Distribution Operations

We currently own and operate two distribution operations that have distribution responsibilities for certain regions that are relatively near our primary facilities. We distribute our bottled water to major retailers in portions of North Carolina, South Carolina, Florida and Virginia. We believe distributing our bottled water in these areas is an important way for us to better understand the bottled water exchange process and provides us the necessary feedback to enhance our independent bottler and distributor relationships. In addition, distributing our bottled water in these areas should assist us in validating the economic arrangements we offer our bottlers and distributors and developing industry knowledge that we can deploy throughout our system. For the year ended December 31, 2009, our two Company-owned distribution operations accounted for approximately 23.5% of our water bottle exchange volume.

Independent Bottler and Distributor Agreements

We have entered into bottler and distributor agreements with each of our independent bottlers and distributors on substantially similar terms. While individual agreements contain variances and exceptions, the material terms of such agreements are described generally below. No individual bottler or distributor is material to our overall financial condition or results of operations.

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Independent Bottler Agreement

In our independent bottler agreement, we appoint a bottler as a non-exclusive supplier of our purified drinking water. The bottler is restricted from competing with us during the term of the agreement and for a specified period after the term in a specified geography.

The bottler is required to bottle and deliver product in conformance with our specifications, including our proprietary mineral formula. The bottler must ensure that our bottled water products comply with applicable laws, rules and regulations (including those of the FDA), industry standards (including those of the International Bottled Water Association) and our quality requirements. The agreement also imposes requirements on the bottler with respect to the maintenance of its facilities and equipment that are intended to ensure the quality of our products.

We provide the necessary bottles, caps, labels, transportation racks, mineral injectors and formula minerals at no charge to the bottler to support the bottling and supply of our bottled water products. The bottler is required to maintain inventory levels necessary to satisfy our production requirements. Product may not be released for shipment until the bottler meets all applicable quality requirements.

Pricing is set forth in the agreement, and we have the right to modify pricing on thirty days notice to the bottler. The agreements generally have a three-year term, and if not otherwise terminated, automatically renew for successive one-year periods after the initial term. Either party may terminate the agreement in the event of an uncured material breach by the other party.

Independent Distributor Agreement

In our independent distributor agreement, we grant a distributor the right to serve as our exclusive delivery and service agent and representative with respect to our bottled water exchange service for a specified term in a specified geographic territory. The distributor is restricted from competing with us during the term of the agreement and for a specified period after the term in the specified geography. We have the right, at any time, to purchase a distributor s rights under the agreement, along with related distribution equipment, for an amount based on the distributor s revenues under the agreement for the prior twelve-month period and the fair market value of the equipment being purchased.

The distributor must perform its services under the agreement in conformance with our distributor manual and all applicable laws and regulations, including those of the FDA.

We compensate a distributor for its services while maintaining a direct relationship with and collecting payments from our retailer customers within the distributor s service territory. Pricing is set forth in the agreement, and we have the right to modify pricing and payment terms on thirty days notice to the distributor.

The agreements generally have a ten-year term, and if not otherwise terminated, automatically renew for successive one-year terms after the initial ten-year term. Either party may terminate the agreement for, among other reasons, an uncured material breach by the other party.

Management Information Systems

We have made a substantial investment in MIS tools which enhance our ability to process orders, manage inventory and accounts receivable, maintain distributor and customer information, maintain cost-efficient operations and assist distributors in delivering products and services on a timely basis. Our technology utilizes highly integrated, scalable software applications that cost-effectively support our growing retail network. Our MIS tools also allow us to analyze historical trends and data to further enhance the execution, service and identification of new markets and marketing opportunities. The primary components of our systems include the following:

Sales and Marketing Support Systems

We operate a single customer relationship management database that integrates all financial and transaction-based data with respect to each retail account. Our MIS tools provide our account managers and customer service representatives access to crucial data to effectively manage each bottler, distributor and retail relationship.

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Bottler and Distributor Level Technology

Our distribution process is highly automated and scalable. Our technology allows bottlers and distributors timely access to information for customer support needs and provides access to real-time data to enhance decisions. In addition, each distributor is electronically linked to our systems with our proprietary Routeview software. Routeview enables distributors to review delivery quantities and tentative scheduling requirements across our entire national network. In addition, our MIS tools allow drivers to update delivery, inventory and invoicing information through handheld devices. This technology provides retailers with accurate and timely inventory and invoices and assists each distributor in managing its responsibilities.

Financial Integration

We utilize Microsoft s Dynamics GP software as our core platform which interfaces with all of our systems. Each handheld device is based on Microsoft s operating system and ensures integration within our reporting and financial databases. All delivery transactions are validated and data is imported into our database tables and mapped to corresponding accounting ledgers.

Manufacturing and Sourcing

Our manufacturing strategy is to utilize independent manufacturers to produce empty water bottles, sales displays and recycle centers and water dispensers at a reasonable cost. We believe that using independent manufacturers has several advantages over our manufacturing these items directly, including (i) decreased capital investment in manufacturing plants and equipment and working capital, (ii) the ability to leverage independent manufacturers purchasing relationships for lower materials costs, (iii) minimal fixed costs of maintaining unused manufacturing capacity and (iv) the ability to utilize our suppliers broad technical and process expertise.

Currently, the majority of our water dispensers are assembled by a single independent manufacturer in China, which utilizes several sub-suppliers to provide components and subassemblies. We have the sole North American rights to develop products with this manufacturer and each dispenser unit is produced to our design specifications. Each unit is inspected and tested for quality by the manufacturer s personnel prior to shipment and any units returned by consumers or retailers are sent directly to the manufacturer for a credit, replacement or refund issued by the manufacturer. Our units generally are shipped directly from Hong Kong to the retailer. For the year ended December 31, 2009, this manufacturer produced water dispenser units that accounted for more than 95% of our water dispenser billings.

Our water bottles and caps are produced by multiple independent vendors throughout the United States. We select suppliers based on price, quality and geographic proximity to our bottlers. We only purchase water bottles with handles as a convenience feature for consumers.

Our sales displays and recycle centers are made to our design. We frequently request bids from multiple independent manufacturers to achieve optimal pricing.

Product Design and Development

A primary focus of our product research and development efforts is developing innovative water dispensers as part of our strategy to enhance consumer awareness and adoption of our water bottle exchange service, increase household penetration and drive sales of our bottled water. We continually work to improve water dispenser features, seek to lower manufacturing costs so that our innovative products are more affordable and introduce new models. Innovative improvements developed in cooperation with our manufacturing partners include bottom-loading dispensers, adjustable hot and cold temperature controls and faster water dispensing capabilities. Our water dispenser models are designed to appeal to consumers of diverse demographic audiences. We expect to introduce a new water dispenser product line in the fourth quarter of 2010. We are also in the early development stage of creating a water dispenser product that provides consumers the ability to dispense multiple purified water-based beverages, including traditional hot drink products and flavored and carbonated beverages.

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Competition

We participate in the highly competitive bottled water segment of the nonalcoholic beverage industry. While the industry is dominated by large and well-known international companies, numerous smaller firms are also seeking to establish market niches. We believe we have a unique business model in the bottled water market in the United States in that we not only offer three- and five-gallon bottled water on a nationwide basis but also provide consumers the ability to exchange their used containers as part of our water bottle exchange service. We believe that we are one of the first companies to provide a national water bottle exchange service at retail. While we are aware of a few direct competitors that operate similar networks, we believe they operate on a much smaller scale than we do and do not have equivalent MIS tools or bottler and distributor capabilities to effectively support major retailers nationwide. Competitive factors with respect to our business include pricing, taste, advertising, sales promotion programs, product innovation, efficient production and distribution techniques, introduction of new packaging, and brand and trademark development and protection.

Our primary competitors in our bottled water business include Nestlé, The Coca-Cola Company, PepsiCo, Dr Pepper Snapple Group and DS Waters of America. While none of these companies currently offers a nationwide water bottle exchange service at retail, Nestlé and DS Waters of America offer this service on a regional basis. However, many of these competitors are leading consumer products companies, have substantially greater financial and other resources than we do, have established a strong brand presence with consumers and have established relationships with retailers, manufacturers, bottlers and distributors necessary to start an exchange business at retail locations nationwide should they decide to do so. In addition to competition between firms within the bottled water industry, the industry itself faces significant competition from other non-alcoholic beverages, including carbonated and non-carbonated soft drinks and waters, juices, sport and energy drinks, coffees, teas and spring and tap water.

We also compete directly and indirectly in the water dispenser marketplace. This marketplace is diverse and faces competition from other methods of purified water consumption such as countertop filtration systems, faucet mounted filtration systems, in-line whole-house filtration systems, water filtration dispensing products such as pitchers and jugs, standard and advanced feature water coolers and refrigerator-dispensed filtered and unfiltered water.

Intellectual Property and Trademarks

We believe that our intellectual property provides a competitive advantage and we have invested substantial time, effort and capital in establishing and protecting our intellectual property rights. We have filed certain patent applications and trademark registration applications and intend to seek additional patents, to develop additional trademarks and seek federal registrations for such trademarks and to develop other intellectual property. We consider our Primo name and related trademarks and our other intellectual property to be valuable to our business and the establishment of a national branded bottled water exchange service. We rely on a combination of patent, copyright, trademark and trade secret laws and other arrangements to protect our proprietary rights. We own ten United States federal trademark registrations, including registrations for our Primo® and Taste Perfection® trademarks, our Primo® logo and our distinctive four bubble design. U.S. federal trademark registrations generally have a perpetual duration if they are properly maintained and renewed. We also own a pending application to register our Zero Waste. Perfect Taste™ trademark in the United States and Canada for use in association with drinking water dispensers, bottled drinking water and a variety of other non-alcoholic beverages. In addition, the design of our recycling center displays is protected by four United States design patents and two Canadian industrial design registrations. The United States design patents expire between May 2021 and April 2022 and, assuming that certain required fees are paid, the Canadian industrial design registrations expire in May 2017. We own three pending utility patent applications in the United States for our bottled water distribution method and bottle return apparatus (or our recycling center displays). Additionally, we are party to a license agreement with The Black & Decker Corporation, which expires December 31, 2010, pursuant to which we provided private label water dispensers to Target that are branded as Black & Decker products.

In addition to patent protection, we also rely on trade secrets and other non-patented proprietary information relating to our product development, business processes and operating activities. We regard portions of our proprietary MIS tools, various algorithms used in our business and the composition of our mineral formula to be

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valuable trade secrets of the Company. We seek to protect this information through appropriate efforts to maintain its secrecy, including confidentiality agreements.

Governmental Regulation

The conduct of our businesses and the production, distribution, advertising, promotion, labeling, safety, transportation, sale and use of our products are subject to various laws and regulations administered by federal, state and local governmental agencies in the United States. It is our policy to abide by the laws and regulations that apply to us, and we require our bottling, manufacturing, and distributing partners to comply with all laws and regulations applicable to them.

We are required to comply with:

- federal laws, such as the Federal Food, Drug and Cosmetic Act and the Occupational Safety and Health Act;
- customs and foreign trade laws and regulations;
- state consumer protection laws;
- federal, state and local environmental, health and safety laws;
- laws governing equal employment opportunity and workplace activities; and
- various other federal, state and local statutes and regulations.

We maintain environmental, health and safety policies and a quality, environmental, health and safety program designed to ensure compliance with applicable laws and regulations.

The United States Food and Drug Administration (the FDA) regulates bottled water as a food under the federal Food, Drug and Cosmetic Act. Our bottled water must meet FDA requirements of safety for human consumption, identity, quality and labeling. Further, the sale and marketing of our products is subject to FDA s advertising and promotion requirements and restrictions. In addition, FDA has established current good manufacturing practice regulations, which govern the facilities, methods, practices and controls used for the processing, bottling and distribution of bottled drinking water. We and our third-party supply, bottling and distribution partners are subject to these requirements. We also must comply with overlapping and sometimes inconsistent state regulations in various jurisdictions. As a result, we must expend resources to continuously monitor state legislative and regulatory activities for purposes of identifying and ensuring compliance with the laws and regulations that apply to our bottled water business in each state in which we operate. While we must meet the government-mandated standards, we believe that our self-imposed standards meet or exceed those set by federal, state and local regulations.

Additionally, the manufacture, sale and use of resins used to make water bottles is subject to regulation by the FDA. Those regulations are concerned with substances used in food packaging materials, not with specific finished food packaging products. We believe our beverage containers are in compliance with FDA regulations. Additionally, the use of polycarbonates in food containers used by children under three years of age is subject to certain state and local restrictions.

Measures have been enacted in various localities and states that require a deposit or tax to be charged for certain non-refillable beverage containers. The precise requirements imposed by these measures vary. Other deposit, recycling or product stewardship proposals have been introduced in various jurisdictions. We anticipate that similar legislation or regulations may be proposed in the future at the local, state and federal levels.

Legal Proceedings

From time to time, we are a party to various lawsuits, claims and other legal proceedings arising from our normal business activities. We have not had, and we do not believe that we have currently, any proceedings that, individually or in the aggregate, would be expected to have a material adverse effect on our business, results of operations or financial condition.

Facilities

Our corporate headquarters, including our principal administrative, marketing, sales, technical support and research and development facilities, are located in Winston-Salem, North Carolina where we lease approximately 14,200 square feet under an agreement that expires on May 31, 2011.

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In addition we lease warehouse space in Winston-Salem and Wilmington, North Carolina; Lakeland, Florida; and Petersburg, Virginia to support our Company-owned operations in these regions. These facilities have lease expirations that vary from November 2010 to May 2012.

We believe that our current facilities are suitable and adequate to meet our current needs, and that suitable additional or substitute space will be available as needed to accommodate expansion of our operations.

Employees

As of June 30, 2010, we had 75 employees. We believe that our continued success will depend on our ability to continue to attract and retain skilled personnel. We have never had a work stoppage and none of our employees are represented by a labor union. We believe our relationship with our employees is good.

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CULLIGAN REFILL ACQUISITION

General

Simultaneously with the closing of this offering, we will acquire certain assets (the Culligan Refill Business) of Culligan Store Solutions, LLC and Culligan of Canada, Ltd. (together with Culligan International Company, Culligan) related to its business of providing reverse osmosis water filtration systems that generate filtered water for refill vending machines and store-use water services in the United States and Canada at approximately 4,500 retail locations. This business also sells empty reusable water bottles for use at refill vending machines (such businesses are together referred to as the Culligan Refill Business). We will fund the $105.0 million purchase price for the Culligan Refill Acquisition with a portion of the proceeds from this offering, with borrowings under our new senior revolving credit facility and through the issuance of our common stock. The acquisition of the Culligan Refill Business is referred to in this prospectus as the Culligan Refill Acquisition .

We have structured the Culligan Refill Acquisition such that its closing will occur promptly following the closing of this offering, and we will not consummate this offering on the terms described in this prospectus unless we believe the Culligan Refill Acquisition will close promptly thereafter. Additionally, we will not be able to consummate this offering unless we are concurrently entering into and closing our new $40.0 million senior revolving credit facility with Wells Fargo Bank, National Association and a group of other lenders on substantially the terms described in this prospectus.

We have structured the transactions in this manner because the proceeds of this offering and the new senior revolving credit are together necessary to fund the cash portion of the purchase price in the Culligan Refill Acquisition and to take the other actions described in Use of Proceeds. The underwriting agreement for this offering will provide that (i) the satisfaction of all conditions precedent to the new senior revolving credit facility (other than the closing of this offering) and the Company receiving gross proceeds in initial borrowings under the new senior revolving credit facility simultaneously with payment for the shares of our common stock offered hereby in an amount sufficient to consummate the transactions described in Use of Proceeds herein and (ii) the satisfaction of all conditions precedent to the Culligan Refill Acquisition (other than the closing of this offering) are both conditions to the closing of the initial public offering. In addition, the asset purchase agreement relating to the Culligan Refill Acquisition provides that the closing of this offering is a condition precedent to the closing of the Culligan Refill Acquisition. We have entered into a commitment letter with Wells Fargo Bank, National Association and Wells Fargo Securities, LLC and a group of other lenders with respect to the new senior revolving credit facility that is subject to certain closing conditions, including the execution of definitive documentation and other customary conditions precedent. We expect these closing conditions will be satisfied concurrently with and will not delay the consummation of the initial public offering. Additionally, we expect all conditions precedent set forth in the asset purchase agreement relating to the Culligan Refill Acquisition other than the consummation of this offering will be satisfied prior to the consummation of this offering such that the Culligan Refill Acquisition will close promptly after the consummation of this offering. As a result of these interrelationships, we expect this offering, the new senior revolving credit facility and the Culligan Refill Acquisition will all close contemporaneously. If we are unable to close our new senior revolving credit facility on substantially the terms described in this prospectus, we will be unable to consummate this offering. In connection with the closing of the Culligan Refill Acquisition, we will be required to pay Wells Fargo Securities, LLC a fee of $1.5 million for financial advisory services provided in connection with the transaction.

The Culligan Refill Business provides filtered water through the installation and servicing of reverse osmosis water filtration systems. Retailers benefit from the reverse osmosis water filtration systems as they ensure water used throughout a store is clean and safe for self-serve refill vending and store-use services, such as food preparation and hydration of produce. Customers of the Culligan Refill Business include Walmart, Safeway, Meijer, Sobeys, Target, Hy-Vee and Kroger. For the year ended December 31, 2009, the Culligan Refill Business generated revenues of $26.0 million and net income of $4.3 million. Approximately 84% of the Culligan Refill Business s revenues were generated in the United States, with operations in 48 states, and approximately 16% of its revenues were generated in Canada across 10 provinces. The Culligan Refill Business s revenues are driven by self-serve refill vending services and empty reusable water bottle sales, which account for approximately 76% and 16% of its revenues, respectively, and to a lesser extent by store-use services.

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The Culligan Refill Business provides us with an established platform to expand into the self-serve water refill business. We believe the Culligan Refill Business is highly complementary to our water bottle exchange business from both a product and operational perspective. We believe the Culligan Refill Acquisition will:

- provide additional consumer value and convenience;
- augment our environmentally friendly product offering;
- allow us to leverage our marketing and increase the sales of our water dispensers;
- enhance our ability to provide retail customers a broad range of hydration solutions;
- deepen our retail customer relationships through a more extensive product offering;
- expand our retail customer base and geographic presence;
- strengthen our distribution network;
- increase our knowledge base of the refill segment and add experienced personnel; and
- provide a source of stable, dependable cash flows to fund future growth.

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The Culligan Refill Business

Overview

The principal product line of the Culligan Refill Business consists of a reverse osmosis water filtration system. This system filters water on site at retail locations and dispenses drinking water on a self service basis. As of June 30, 2010, the Culligan Refill Business had installed its reverse osmosis water filtration systems in approximately 4,500 retail customer locations in the United States and Canada.

Reverse Osmosis Water Filtration System

The reverse osmosis water filtration system that the Culligan Refill Business installs and maintains generally consists of a refill vending machine located within its customers retail space and reverse osmosis filtration equipment that is typically located in the back room of the retail customers store location. The refill vending machine is typically accompanied by a sales display containing empty reusable water bottles.

Refill Vending Machine and Empty Reusable Water Bottles

The use of reverse osmosis filtration equipment located in the back room benefits the retail customer in several ways, including:

- minimizing the refill vending machine s footprint within the customer s retail space;
- allowing the retail customer to use the filtered water for internal purposes such as in produce misters, ice makers and the customer s bakery;
- allowing preventative maintenance, repair and meter reading with minimal consumer interruption; and
- allowing filtration equipment modifications to increase water volume handling capacity without an increased footprint within the customer s retail space.

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Reverse Osmosis Water Filtration System

Retail customers also benefit from the filtration equipment as using filtered water for store-use purposes such as produce misters and ice makers extends the life of and reduces maintenance costs with respect to the retail customers in-store equipment.

The Culligan Refill Business also sells to retail customers a line of one-, three- and five-gallon empty reusable bottles to be sold to consumers for use at the refill vending machines.

During 2009, the Culligan Refill Business derived revenues from the following activities:

- 76% of its revenues from the sale of filtered drinking water through refill vending machines;
- 16% of its revenues from the sale of empty reusable water bottles; and
- 8% of its revenues from the store-use by its retail customers of the reverse osmosis water filtration system for produce misters, ice makers, the customer s bakery and other similar uses.

Marketing

Sales and marketing to retail customers of the Culligan Refill Business is accomplished primarily through direct selling activities. Sales managers and field sales personnel call directly on major retail accounts. Sales to consumers are accomplished principally through point of sale displays and literature at the site of each refill vending machine. The Culligan Refill Business also uses traditional merchandising techniques such as free samples, coupons, special pricing and other in-store promotional techniques to promote consumption of drinking water by the ultimate consumer.

We are required to rebrand the Culligan Refill Business within 12 months after the closing of the Culligan Refill Acquisition.

Product Distribution

The reverse osmosis water filtration systems used in the Culligan Refill Business 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, the Culligan Refill Business owns the water filtration system and contracts for the provision of all required service and maintenance. Water meters are generally read monthly by a third-party representative and an invoice is subsequently delivered to the retailer.

The revenue realized by the Culligan Refill Business on each reverse osmosis water filtration system is highly dependent upon the overall volume of water sold through a particular location. The consumer typically pays a price to the retailer for water from the refill vending machine ranging from approximately $0.25 to $0.50 per gallon, depending upon the location and the retailer s overall pricing strategy. When accounting for the wholesale costs of water, we believe the retailers of the Culligan Refill Business receive a gross margin of approximately 50%. The competitive nature of product pricing varies by geographic location.

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Certain retail customers also use the reverse osmosis water filtration system for produce misters, ice makers, the customer s bakery and other similar uses. These retail customers are billed monthly for this store water usage with the charges based on each particular store s volume of water used.

Customers

A significant portion of the revenues of the Culligan Refill Business comes from a small group of major retail customers. For the year ended December 31, 2009, Walmart accounted for 65% of the net sales of the Culligan Refill Business, and no other retail customer accounted for more than 10% of its net sales. As of June 30, 2010, the Culligan Refill Business had installed its reverse osmosis water filtration systems in approximately 4,500 retail customer locations in 48 U.S. states (a total of approximately 3,800 locations) and 10 Canadian provinces (a total of approximately 700 locations). The Culligan Refill Business has long-standing relationships with most of its major retail customers. For example, its business relationship with Walmart began in 1991 and its business relationships with its next four largest retail customers began in 2005, 1995, 2000 and 1998, respectively.

Operational Process

The Culligan Refill Business has divided its operating territory into seven distinct geographic regions. The Culligan Refill Business has a district vending manager for each region who is responsible for managing the operations within the region as well as the oversight, support and management of the service providers servicing the retail locations within the region.

Sales Process

The Culligan Refill Business employs a direct sales force that actively pursues headquarters-based retail relationships to better serve the retailer customers and to minimize layers of approval and decision-making with regard to the addition of new retail locations. Upon confirmation of a new retail location, the Culligan Refill Business coordinates with the retailer and the service provider to schedule an installation in a timely manner.

The reverse osmosis water filtration system is part of a turn-key program for retailers in which the network of service providers actively service each retail account. After the water filtration equipment is installed and operational, the service provider completes on-site training with the retailer and has an ongoing economic interest in supporting and growing the business relationship to increase gallon sell through as the service providers are paid by the Culligan Refill Business based upon a percentage of water volume sales, subject to minimum and maximum commission amounts.

Retail Relationships

While individual retail locations are typically serviced by third party service providers, the customer relationship is owned and maintained by the experienced retail sales and service organization at the Culligan Refill Business, which allows a strong customer affinity and the maintenance of key headquarters-based relationships. The sales team routinely reviews sales results and trends with retail customers to provide suggestions for improving the sell through. The retail relationships are divided into regions and managed by sales and service personnel.

Service Providers

The Culligan Refill Business has over 500 service providers who 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. These service providers are comprised of

Culligan International franchised dealers, service providers owned by subsidiaries of Culligan International and third-party service providers, which are responsible for serving retail store locations representing 55%, 27% and 18% of the revenues of the Culligan Refill Business for the year ended December 31, 2009, respectively. Typically, a service provider is paid a commission based on a percentage of the total revenues at the locations for which the service provider is responsible, subject to minimum and maximum commission amounts. Service providers also earn an hourly rate for initial installations of the reverse osmosis water filtration systems.

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The Culligan Refill Business employs a field service team which provides training and support to its service providers and retail customers.

Reverse Osmosis Water Filtration Systems

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. An installation typically takes a few hours to complete, and the service provider that installed the system provides a completed work order to confirm the installation.

The Culligan Refill Business employs an operations team which assembles, refurbishes and repairs the refill vending machines. This team is located in its Eagan, Minnesota facility, where it routinely refurbishes equipment that has been in service for five years and longer 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 service providers. The component parts are generally sourced from multiple suppliers.

Maintenance

The regular maintenance completed by the service providers generally includes a monthly sanitization of the reverse osmosis water filtration system, 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 the Culligan Refill Business operates have specific bimonthly, monthly, quarterly or annual water testing reporting requirements with which it complies, but it performs water tests on each reverse osmosis water filtration system at least quarterly.

Customer Service

The Culligan Refill Business has a customer service team which coordinates service and bottle order replenishment requests from its retail customers. All calls are received and tracked through a toll-free telephone number for the United States and a separate telephone number for Canada. This team coordinates service requests to the service provider network and manages work orders to ensure completion of the service request. This team also addresses any consumer questions.

Administration

The accounting department of the Culligan Refill Business is responsible for billing and collecting from retail customers. Retailers are typically billed monthly based on a meter reading performed by the service provider that is faxed to the billing department. The billing team enters the meter reading into a billing system and generates invoices for the retail customer, which are sent electronically or by mail to the retail customer. Retail customers generally have 30 day terms to pay invoices. The Culligan Refill Business utilizes an ERP system and document imaging system and has supplemented the system with its billing system.

Bottle Sourcing

The Culligan Refill Business sources empty reusable bottles from several manufacturing sources. The bottles are managed, inventoried and shipped through a 16,000 square foot leased warehouse facility in Oklahoma City, Oklahoma. The Culligan Refill Business co-owns with the bottle manufacturers certain bottle molds for bottles exclusively purchased for retailers.

The Culligan Refill Business has historically used a variety of suppliers and does not believe it is materially dependent on any single supplier. Alternate sources of supply are available for all of the critical components used in the Culligan Refill Business.

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Services Agreements

The Culligan Refill Business has historically entered into services arrangements with its retail customers pursuant to which the Culligan Refill Business agrees to install and maintain its reverse osmosis water filtration system within the retail customer s store in exchange for typically monthly payments from the retail customer based on the store s water volume usage. These arrangements generally have terms of one to five years and the original terms of many of the agreements have expired. In such cases the arrangements have generally been automatically renewed or continue to operate on the same terms.

Competition

The Culligan Refill Business participates in the highly competitive bottled water segment of the nonalcoholic beverage industry. While the industry is dominated by large and well-known international companies, numerous smaller firms are also seeking to establish market niches. The business model of the Culligan Refill Business is differentiated from most of the participants in the North American nonalcoholic beverage industry in that it offers self-service refill of drinking water. There are a few direct competitors that offer similar refill vending services, but with the exception of Glacier Water Services, Inc., we believe these direct competitors generally operate on a smaller geographical and operational scale than the Culligan Refill Business. The Culligan Refill Business faces two levels of competition: (i) competition at the retail customer level to secure placement of its reverse osmosis water filtration systems in the store; and (ii) competition at an end-user level to convince consumers to purchase its water versus other options. Competitive factors with respect to the Culligan Refill Business include pricing, taste, advertising, sales promotion programs, retail placement, introduction of new packaging and branding.

Many of the indirect competitors in the bottled water segment of the nonalcoholic beverage industry are leading consumer products companies, have substantially greater financial and other resources than the Culligan Refill Business or us, have established a strong brand presence with consumers and have established relationships with retailers, manufacturers, bottlers and distributors necessary to start a self-service drinking water refill business at North American retail locations should they decide to do so. In addition to competition between firms within the bottled water industry, the industry itself faces significant competition from other nonalcoholic beverages, including carbonated and non-carbonated soft drinks and waters, juices, sport and energy drinks, coffees, teas and spring and tap water.

Intellectual Property and Trademarks

There are no material registered patents, trademarks or copyrights related to the Culligan Refill Business that we are acquiring in connection with the Culligan Refill Acquisition. However, employees of the Culligan Refill Business that will be joining our Company do possess important know-how related to the self-service drinking water refill business and the reverse osmosis water filtration systems offered by the Culligan Refill Business. We consider this know-how to be an important part of the Culligan Refill Business and one of the principal reasons we believe the Culligan Refill Business will provide our Company a solid platform to include self-service drinking water refill in our product offerings.

Governmental Regulation

The conduct of the Culligan Refill Business and the production, distribution, advertising, promotion, labeling, safety, sale and use of its products are subject to various laws and regulations administered by federal, state, provincial and local governmental agencies in the United States and Canada. It is the policy of the Culligan Refill Business to abide by the laws and regulations that apply to it and the Culligan Refill Business requires manufacturing and service provider partners to comply with all laws and regulations applicable to them.

The refill vending machines used in the Culligan Refill Business are certified by the National Automatic Merchandising Association (NAMA). NAMA maintains a vending machine certification program which evaluates food and beverage vending machines against current requirements of the U.S. Public Health Service Ordinance and Code. The manufacturing facility used in connection with the Culligan Refill Business is required to be registered with the EPA under the provisions of the Federal Insecticide, Fungicide and Rodenticide Act because

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certain components used in connection with the reverse osmosis water filtration systems are deemed to be pesticidal devices. The Eagan, Minnesota facility has been registered as required.

Certain states have permit requirements for the operation of the refill vending machines. The Culligan Refill Business uses outside laboratories to periodically test the quality of the water dispensed through the refill vending machine. The water dispensed through the refill vending machine is also regularly tested by outside laboratories for the presence of coliform bacteria.

Legal Proceedings

From time to time, the Culligan Refill Business has been involved in various lawsuits, claims and other legal proceedings arising from its normal business activities. The Culligan Refill Business is not currently the subject of any proceedings that, individually or in the aggregate, would be expected to have a material adverse effect on its business, results of operations or financial condition.

Facilities

The Culligan Refill Business is headquartered in Eagan, Minnesota. We will assume the office lease relating to the headquarters facility for a term that expires in October 2014.

The Culligan Refill Business uses one warehouse and distribution facility located in Oklahoma City, Oklahoma. We will assume the lease related to this facility covering approximately 16,000 square feet for a term that is on a month-to-month basis.

We believe that these facilities are suitable and adequate to meet our current needs with respect to the Culligan Refill Business, and that suitable additional or substitute space will be available to accommodate expansion of these operations.

Employees

As of June 30, 2010, the Culligan Refill Business had approximately 50 employees, none of which are represented by a labor union or covered by a collective bargaining agreement.

MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF THE CULLIGAN REFILL BUSINESS

The following discussion and analysis of the financial condition and results of operations of the Culligan Refill Business should be read in conjunction with the financial statements and related notes of the Culligan Refill Business appearing elsewhere in this prospectus. The actual results of the Culligan Refill Business could differ materially from those anticipated in the forward-looking statements included in this discussion as a result of certain factors, including, but not limited to, those discussed in the section of this prospectus titled Risk Factors.

Overview

The Culligan Refill Business provides reverse osmosis water filtration systems that generate filtered water for refill vending machines and store-use water services in the United States and Canada at approximately 4,500 retail locations. This business also sells empty reusable water bottles for use at refill vending machines. Retailers benefit from the Culligan Refill Business as it ensures water used throughout a store is clean and safe for self-serve refill vending and store-use services, such as food preparation and hydration of produce. Customers of the Culligan Refill Business include Walmart, Safeway, Meijer, Sobeys, Target, Hy-Vee and Kroger. For the year ended December 31, 2009, the Culligan Refill Business generated revenues of $26.0 million and net income of $4.3 million. Approximately 84% of the Culligan Refill Business s revenues were generated in the United States, with operations in 48 states, and approximately 16% of its revenues were generated in Canada across 10 provinces. The Culligan Refill Business s revenues are principally driven by self-serve refill vending services, empty reusable water bottle sales and store-use services, which account for approximately 76%, 16% and 8% of revenues, respectively.

Results of Operations

The following table sets forth the results of operations of the Culligan Refill Business for the periods indicated:

	Years Ended December 31,		Six Months Ended June 30,	
	2008	2009	2009	2010
	(In thousands)			
			(Unaudited)	
Consolidated statements of operations data:				
Net sales	$ 25,746	$ 26,017	$ 12,687	$ 12,569
Operating costs and expenses				
Cost of sales	13,635	13,643	6,778	6,654
Selling, general and administrative expenses	3,270	2,877	1,255	1,395
Depreciation and amortization	3,872	2,488	1,215	1,360
Total operating costs and expenses	20,777	19,008	9,248	9,409
Income from operations	4,969	7,009	3,439	3,160
Provision for income taxes	1,837	2,665	1,305	1,210

Net income	$ 3,132	$ 4,344	$ 2,134	$ 1,950

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The following table sets forth the results of operations for the Culligan Refill Business expressed as a percentage of net sales for the periods indicated:

	Years Ended December 31,		Six Months Ended June 30,	
	2008	2009	2009	2010
			(Unaudited)	
Consolidated statements of operations data:				
Net sales	100%	100%	100%	100%
Operating costs and expenses				
Cost of sales	53.0%	52.4%	53.4%	53.0%
Selling, general and administrative expenses	12.7%	11.1%	9.9%	11.1%
Depreciation and amortization	15.0%	9.6%	9.6%	10.8%
Total operating costs and expenses	80.7%	73.1%	72.9%	74.9%
Income from operations	19.3%	26.9%	27.1%	25.1%
Provision for income taxes	7.1%	10.2%	10.3%	9.6%
Net income	12.2%	16.7%	16.8%	15.5%

Six Months Ended June 30, 2010 Compared to Six Months Ended June 30, 2009

Net Sales. Net sales for the first half of 2010 decreased slightly by $0.1 million or 0.9% to $12.6 million from $12.7 million in the first half of 2009. The decrease in sales resulted primarily from lower volume in the U.S. in the vended water business.

Gross Margin. Overall gross margin, defined as net sales less cost of sales, as a percentage of net sales increased to 47.0% for the first half of 2010 from 46.6% for the first half of 2009. The primary reason for the favorable change in margin was lower material costs.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for the first half of 2010 and 2009 were $1.4 million and $1.3 million, respectively, and as a percentage of net sales, increased to 11.1% for the first half of 2010 from 9.9% for the first half of 2009. Selling, general and administrative expenses increased as a result of favorable bad debt and employee compensation related expenses in the first half of 2009 that did not reoccur the first half of 2010.

Depreciation and Amortization. Depreciation and amortization increased 11.9% to $1.4 million in the first half of 2010 from $1.2 million in the first half of 2009. The increase in depreciation and amortization is primarily due to an increase in capital expenditures over the last twelve months.

Year Ended December 31, 2009 Compared to Year Ended December 31, 2008

Net Sales. Net sales for 2009 increased $0.3 million or 1.2% to $26.0 million from $25.7 million in 2008. The increase in sales resulted from a price increase as well as slightly higher volumes.

Gross Margin. Our overall gross margin, defined as net sales less cost of sales, as a percentage of net sales increased to 47.6% for 2009 from 47.0% for 2008. The primary reasons for the favorable change in margin were benefits from a price increase and slightly lower expenses.

Selling, General and Administrative Expenses. Selling, general and administrative expenses for 2009 decreased $0.4 million or 12.1% to $2.9 million from $3.3 million and, as a percentage of net sales, decreased to 11.1% for 2009 from 12.7% for 2008. Selling, general and administrative expenses decreased as a result of lower bad debt and salary related expenses.

Depreciation and Amortization. Depreciation and amortization decreased by $1.4 million or 35.9% to $2.5 million in 2009 from $3.9 million in 2008. The decrease in depreciation and amortization expense is due to a significant amount of assets becoming fully depreciated in 2008.

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Critical Accounting Policies and Estimates

Revenue Recognition. Vended water dispensing machines placed at the retailers are used by consumers on a self-serve basis. Revenue is recognized at the time the meters are read during the servicing of the vended water dispensing machines. At December 31, 2009, there were approximately 4,500 refill vending machines, making the servicing of each machine at the end of each reporting period impractical. Consequently, the Culligan Refill Business estimates the revenue from the last time each machine was serviced until the end of the reporting period, based on the most current average daily volume of each machine. For the years ended December 31, 2009 and 2008, the Culligan Refill Business recorded approximately $1,051 and $1,050, respectively, of such revenues, which for both year-ends represent an average of approximately 22 days of use per machine.

The Culligan Refill Business recognizes revenue when empty bottles are shipped and the customer takes ownership and assumes risk of loss, collection of the relevant receivable is probable, persuasive evidence of an arrangement exists and the sales price is fixed or determinable. Shipping and other transportation costs charged to buyers are recorded in cost of sales.

Foreign Currency Translation. The Culligan Refill Business s operations are in the U.S. and Canada. Assets and liabilities denominated in Canadian dollars are translated into U.S. dollars at the current rate of exchange existing at period-end. Revenues, expenses, gains, and losses are translated at average monthly exchange rates. Translation adjustments are included in the combined statements of parent equity and comprehensive income for the Culligan Refill Business.

Goodwill and Other Intangible Assets. Goodwill reflected in the Culligan Refill Business s financial statements represents an allocation of the goodwill, the excess of costs over fair value of assets of business acquired, recorded by Culligan Holding S.àr.l at the date of acquisition of the Culligan Refill Business. The relative fair value approach was used as the basis for the allocation. The Culligan Refill Business is a component of the Culligan Holding S.àr.l reporting unit. Goodwill is not amortized but is instead tested at the reporting unit level for impairment at the reporting unit level at least annually in accordance with Accounting Standards Codification (ASC) Topic 350, *Intangibles- Goodwill and Other* (ASC 350). Culligan Holding S.àr.l completed its annual goodwill impairment tests as of December 31, 2009 and 2008 and determined that goodwill was not impaired during these years.

Impairment of Long-Lived Assets. The Culligan Refill Business reviews whether events or circumstances subsequent to the acquisition of any long-lived assets have occurred that indicate the remaining estimated useful lives of those assets may warrant revision or that the carrying value of those assets may not be recoverable. If events or circumstances indicate that the long-lived assets should be reviewed for possible impairment, the Culligan Refill Business uses projections to assess whether future cash flows on a nondiscounted basis related to the tested assets are likely to exceed the recorded carrying amount of those assets, to determine whether a write-down is appropriate. Should an impairment be identified, a loss would be recorded to the extent that the carrying value of the impaired assets exceeds their fair value as determined by valuation techniques appropriate in the circumstance, which could include the use of similar projections on a discounted basis. No such events or circumstances were identified during the years ended December 31, 2009 and 2008.

Fair Value of Financial Instruments. Financial instruments consist primarily of accounts receivable, accounts payable, and accrued liabilities. The carrying amounts of such instruments are considered to be representative of their respective fair values due to the short-term maturity of the instruments.

Concentrations of Risk. The Culligan Refill Business offers products and services to a fairly diverse customer base; however, one customer accounted for approximately 65% and 63% of the Culligan Refill Business s revenues in 2009 and 2008 and approximately 57% and 59% of accounts receivable as of December 31, 2009 and 2008, respectively.

There is no significant supplier, product line, credit, geographic, or other concentrations that could expose the Culligan Refill Business to adverse near term severe financial impacts.

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Culligan Refill Acquisition Agreements

Asset Purchase Agreement

On June 1, 2010, we entered into an asset purchase agreement with Culligan to purchase the assets related to the Culligan Refill Business for a total purchase price of $105.0 million consisting of:

- a cash payment of $60.0 million; and
- the issuance of shares of our common stock with a value of $45.0 million based upon the price that we issue shares in this offering (or 3,750,000 shares, assuming an initial public offering price of $12.00 per share, the midpoint of the range set forth on the cover page of this prospectus).

The purchase price for the Culligan Refill Business is subject to a working capital adjustment that is to be finally determined after the closing of the transaction. There will be a dollar-for-dollar adjustment to the purchase price if the actual working capital amount is above or below the target working capital of approximately $2.0 million. The cash portion of the purchase price will be increased and the number of shares of common stock we will issue will be decreased by an amount equal to the net cash proceeds we receive from any exercise of the underwriters over-allotment option. We will also assume certain specifically identified liabilities in connection with the Culligan Refill Acquisition.

The asset purchase agreement contains customary representations, warranties, covenants and conditions to closing, including a condition related to the closing of the initial public offering. We will be required to close the Culligan Refill Acquisition if we obtain permits to operate refill vending machines representing at least 80% of the revenues of all of the refill vending machines that are part of the Culligan Refill Business for the year ending December 31, 2009. However, we do not anticipate such percentage to be obtained prior to closing and we expect to waive such condition and close without a minimum percentage of permits.

In connection with the closing of the Culligan Refill Acquisition, we have entered or will enter into a trademark license agreement, two transition services agreements, a dealer services agreement, a non-compete agreement, a supply agreement, a lock-up agreement, a registration rights agreement and employment agreements with Jeanne Cantu, Vice President and General Manager of the Culligan Refill Business, and Carl Werner, Controller of the Culligan Refill Business.

Trademark License Agreement

At the closing of the Culligan Refill Acquisition, we will enter into a trademark license agreement with Culligan International Company, pursuant to which Culligan International Company will grant us a non-exclusive, royalty-free right and license to use certain of Culligan s trademarks in connection with the Culligan Refill Business within the United States and Canada. The term of the trademark license agreement is one year, unless sooner terminated in accordance with its provisions.

Transition Services Agreements

United States Transition Services Agreement

At the closing of the Culligan Refill Acquisition, we will enter into a transition services agreement with Culligan International Company, pursuant to which Culligan International Company will provide or cause to be provided certain services, including payroll and information technology services at no charge. We will use our commercially reasonable efforts to end our use of the provided services as soon as reasonably possible. Culligan International

Company will provide such support as we may reasonably request to assist us in obtaining replacement services and exiting from the systems of Culligan International Company on or before the termination of the transition services agreement. This transition services agreement has a 60-day term, which commences on the date of the closing of the Culligan Refill Acquisition.

Canada Transition Services Agreement

At the closing of the Culligan Refill Acquisition, we will enter into a transition services agreement with Culligan of Canada, Ltd., pursuant to which Culligan of Canada, Ltd. will provide or cause to be provided certain services, including information technology, accounting and billing services at a rate of CAD$28,250 per month. This transition services agreement will terminate on December 31, 2011 unless earlier terminated in accordance with its terms.

Dealer Services Agreement

At the closing of the Culligan Refill Acquisition, we will enter into a dealer services agreement with Culligan International Company, pursuant to which Culligan International Company will provide us with access to the Culligan-owned service providers and its franchisee service providers and will cause, or use commercially reasonable efforts to cause, such service providers to conduct the services they currently conduct with respect to the refill vending machines. The dealer services agreement will terminate on December 31, 2011 unless earlier terminated in accordance with its terms.

Non-Compete Agreement

At the closing of the Culligan Refill Acquisition, we will enter into a non-competition agreement with Culligan Store Solutions, LLC, Culligan of Canada, Ltd., and Culligan International Company, pursuant to which the Culligan entities will agree, subject to certain exceptions, to refrain from engaging in certain conduct for a period of five years, including:

- selling or providing certain products and services related to refill vending machines within a specified territory;
- soliciting or accepting as a customer any customer of the Culligan Refill Business for purposes of marketing, selling or providing certain products and services to such customer;
- soliciting or hiring certain current employees of the Culligan Refill Business; or
- providing certain products and services to any person for use by any person to engage in business similar to that of the Culligan Refill Business within a specified territory.

Supply Agreement

At the closing of the Culligan Refill Acquisition, we will enter into a supply agreement with Culligan International Company pursuant to which it has agreed to sell us certain water filtration equipment and products. This supply agreement has a one-year term, but will automatically renew for one-month periods unless either party provides notice of termination at least 30 days prior to the expiration of the then current term.

Lock-Up Agreement

Culligan Store Solutions, LLC and Culligan International Company have entered into a lock-up agreement pursuant to which they have agreed, subject to certain exceptions, not to offer, sell, contract to sell, pledge, grant any option to purchase, make any short sale or otherwise dispose of any shares of common stock, or any securities convertible into, exchangeable for or that represent the right to receive shares of common stock for a period of 180 days from the date of this prospectus without the prior written consent of Thomas Weisel Partners LLC (an affiliate of Stifel, Nicolaus & Company, Incorporated). There are no contractually specified conditions for the waiver of lock-up restrictions and any waiver is at the sole discretion of Thomas Weisel Partners LLC, which may be granted by Thomas Weisel Partners LLC for any reason. The 180-day lock-up period will be automatically extended if (i) during the last 17 days of the 180-day restricted period we issue an earnings release or announce material news or a material event or (ii) prior to the expiration of the 180-day restricted period, we announce that we will release earnings results during the 15-day period following the last day of the 180-day period, in which case the restrictions described in this paragraph will continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the announcement of the material news or material event. After the lock-up period, these shares may be sold, subject to compliance with applicable securities laws.

Registration Rights Agreement

At the closing of the Culligan Refill Acquisition, we will enter into a registration rights agreement with Culligan International Company pursuant to which we will agree, subject to certain exceptions, to prepare and file a registration

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statement to register the shares of our common stock received by Culligan in connection with the Culligan Refill Acquisition within 181 days of the consummation of the transaction. If this registration statement is not declared effective within such 181-day period or, subject to certain limitations, Culligan is not permitted to make sales pursuant to such registration statement after it is declared effective, we will be required to pay Culligan a ticking fee for any such period during which the registration statement is not effective or sales cannot be made. Such ticking fee will generally be calculated by multiplying Culligan s cost of capital at the relevant time (up to 12%) by the value of shares of our common stock then held by Culligan (calculated based upon the price we are selling shares in this offering).

Employment Agreements

Jeanne Cantu

We have entered into an employment agreement with Jeanne Cantu that is effective upon the closing of the Culligan Refill Acquisition pursuant to which Ms. Cantu has agreed to serve as a Vice President and General Manager of the Culligan Refill Business. Ms. Cantu will receive a base salary of $168,100, would receive severance in certain circumstances and would be subject to a one year non-competition covenant. This employment agreement has a term of two years.

Carl Werner

We have entered into an employment agreement with Carl Werner that is effective upon the closing of the Culligan Refill Acquisition pursuant to which Mr. Werner has agreed to serve as Controller of the Culligan Refill Business. Mr. Werner will receive a base salary of $91,637, would receive severance in certain circumstances and would be subject to a one year non-competition covenant. This employment agreement has a term of two years.

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