Snap One (Q2 2021 Earnings)

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Corporate Speakers:

- Eric Steele; Snap One Holdings Corp.; Vice President, Investor Relations
- John Heyman; Snap One Holdings Corp.; CEO & Director
- Mike Carlet; Snap One Holdings Corp.; CFO
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Participants:

- Erik Woodring; Morgan Stanley; Research Associate
- Paul Chung; JPMorgan; Analyst
- Stephen Volkmann; Jefferies LLC; Equity Analyst
- Chris Snyder; UBS Investment Bank; Analyst
- Ketan Mamtora; BMO Capital Markets Equity Research; Analyst
- Ryan Merkel; William Blair & Company L.L.C.; Research Analyst
- Adam Tindle; Raymond James & Associates, Inc.; Senior Research Associate
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PRESENTATION

Operator: Good day, and thank you for standing by. Welcome to the Snap One Fiscal Second Quarter 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. (Operator Instructions) I would now like to turn the call over to your host, Eric Steele, Vice President, Investor Relations. Please go ahead.

Eric Steele: Thank you. Good afternoon, and welcome to Snap One's Fiscal Second Quarter 2021 Earnings Conference Call. As a reminder, this call is being recorded. Joining us today from Snap One are John Heyman, CEO; and Mike Carlet, CFO.

Before we begin, we would like to remind everyone that our prepared remarks contain forward-looking statements and management may make additional forward-looking statements in response to your questions, including, but not limited to, statements of expectations, future events or future financial performance. These statements do not guarantee future performance, and therefore, undue reliance should not be placed upon them.

Although we believe these expectations are reasonable, we undertake no obligation to revise any statements to reflect changes that occur after this call. Actual events or results could differ materially.

These statements are based on current expectations of the company's management and involve risks and uncertainties, including those identified in the Risk Factors section of our registration statement on Form S-1 filed with the SEC.

All non-GAAP financial measures referenced in today's call are reconciled in our earnings press release to the most directly comparable GAAP measure. This call also contains time-sensitive information that is accurate only as of the date of this broadcast, August 26, 2021. Finally, I would like to remind everyone that this conference call is being webcast and a recording will be made available for replay on our Investor Relations website at investors.snapone.com. I will now turn the call over to our CEO, John Heyman. John?

John Heyman: Eric, thank you. And thanks for all of your leadership over the past quarters or so. First of all, welcome, everyone. Thanks for spending time with us this afternoon. I hope everybody's families are healthy. Recognizing that many of you might be new to the Snap One story, I'm going to start today's discussion with a brief history and overview of our business. Then I'm going to review some recent updates and highlights, and I'll turn it over to Mike Carlet, our CFO, to discuss financial results for the quarter and to provide guidance for the remainder of 2021. And I'll have some closing remarks after that, and then we'll open up the call for questions.

So let's get to it. At Snap One, our mission is to bring together the best people, integrators and products to make lives more enjoyable, connected and secure. We began as SnapAV in 2005. We were founded by 2 professional integrators who saw an opportunity to transform how integrators and the smart living industry were served.

These integrators work with consumers every week to design smart living experiences. They design, they purchase, they install and then support the products required to bring those experiences to life. The process of evaluating products, locating them, purchasing them, receiving them, installing them and then supporting these products for any given project was very time-consuming and expensive, and our company set out to dramatically improve what was an inefficient process.

From the beginning, we understood the challenges that these integrators faced, and we sought to make their lives easier. We invested in their success so that they could deliver on the promise of the smart home and business for the end customers who depended on them.

We disrupted the industry with things like an e-commerce ordering portal, brands exclusively sold through these integrators and award-winning service and technical support. With this value proposition, we grew rapidly by expanding our professional integrator base and our product portfolio.

As the smart living industry has evolved, we continue to raise the bar. First, we've diversified from our initial products like cables and racks and mouse to more technically complex and software-driven products such as networking, surveillance, smart power. And these are all supported by our industry-leading remote management software platform overseeing.

We've also complemented our revered e-commerce platform with brick-and-mortar locations to reach a new group of integrators, deliver local services like product training, technical consultations and last-minute delivery and, of course, provide an omnichannel shopping convenience.

We've also opened our ecosystem to third-party products and began reselling a curated set of non-Snap One brands with the goal of providing integrators with a one-stop shop, if you will, for all the products needed to complete a job.

And finally, most recently, we've entered the strategically important control and automation category with the 2019 acquisition of the industry-leading platform, control platform Control4. Together with Control4's automation platform, we're able to deliver more reliable and fully integrated systems.

We've accomplished all these advancements through significant internal advance -- significant internal investment and strategic M&A. Over the past 5 years, we've successfully completed 10 acquisitions, ranging from local distributors to leading technology companies like Control4.

To reflect our evolution, we recently rebranded the company, and we're very excited about that to Snap One, and this represents our aspiration to be the one partner that professional integrators need for every job. We removed the AV, the audiovisual part of our name because our company and our industry have expanded well beyond just entertainment solutions. As solutions get more complex and get more intertwined, we're dedicated to keeping things simple by providing exceptional product quality and selection, premium service and support and an omnichannel shopping experience.

The name Snap One encompasses all we are today and our intent to continue to lead the industry in the future. Here at Snap One, our B2B2C business model is purpose-built to drive value for all of our stakeholders. We're very well positioned to provide our loyal and growing network of over 16,000 professional do-it-for-me integrators with leading products, software platforms, technology-enabled workflow solutions that will help them successfully serve their customers and operate their businesses.

With our partnership, our integrators can delight end consumers by selecting the right products, performing complex and manually intensive installations, supporting the system and bringing the entire experience together in a unified way. Our integrator success is our success. And by partnering with Snap One, our integrators can focus on their trade and leverage the tools and the infrastructure that we deliver to build thriving and profitable businesses.

Our strong value proposition creates a reoccurring spending pattern with these integrators that strengthened our relationships and enhance our revenue visibility from the integrator base. We were founded by integrators, for integrators, and we carry that legacy with us being a leader in the industry as our integrators partner of choice.

So with that as a backdrop, now let me get into where our business is today. Over the past few months, we've made considerable operational progress and completed several milestone achievements for our business highlighted by our public listing in July.

The IPO was a momentous occasion for our industry, our integrators and yes, our company. I'd like to thank everybody for their tireless support and we're confident that the future is very bright for Snap One. Let me take a moment and recap a few of the highlights.

First, we've expanded our omnichannel distribution presence into 5 new domestic markets. We opened or acquired brick-and-mortar locations in Charlotte, Scottsdale, Denver, Salt Lake and Atlanta. This brings our nationwide footprint to 27 locations as of quarter end. All of these locations now makes Snap One's leading products immediately available for local integrators while extending our service offering through deeper sales, training and support engagement.

Second, we were humbled to be recognized as the #1 or the #2 brand, sometimes both, 36 times across 62 identified product categories in the 2021 CE Pro 100 Brand Analysis awards. The company earned approximately 5 times the number of 1 and/or 2 awards at the next most awarded competitor.

This follows our record performance in CE Pro's 2021 Quest for Quality Awards, which were released in March and recognize the best service providers to the industry. Snap One was recognized for 16 awards in the Quest for Quality Award, approximately twice as many as the nearest competitor.

Together, these awards demonstrate the company's leadership position in the market and competitive differentiation across our product and service capabilities. Third, we've upgraded our Control4 OS3 software to provide full support for overseas remote management to our Control4 controllers.

This was a major enhancement, envisioned at the time of our Control4 acquisition, and it strengthens our commitment to make life simpler for integrators by offering them the ability to remotely manage and service clients control for connected devices through the oversea platform. With increased system visibility, integrators can more easily offer service contracts, troubleshoot devices and reduce service costs.

And finally, we acquired Access Networks, the enterprise-grade leading network solutions provider, offering networking products, design, configuration, monitoring and support services. The network is the digital backbone of smart living and this acquisition enhances Snap One's networking solutions for residential and commercial applications. We also announced a significant investment in Parasol an industry-leading provider of 24/7 remote support subscriptions that improve integrator productivity and service levels. Both actions provide further momentum for our long-term strategy to support integrator customers across the project life cycle.

I'll touch on the financials before handing it over to Mike to discuss more. Number one, we delivered impressive results in several key performance areas, namely a 34% increase in net sales to over $253 million and a 20% increase in non-GAAP adjusted EBITDA to approximately $29 million during the period.

The business experienced growth across product categories, geographic regions, markets, et cetera, as we added new integrators, increased spend per integrator and let the demand drop from COVID-19 in the second quarter of 2020. I'll talk quickly about demand sensors that we see and then long-term growth.

As we assess the current demand for smart living solutions, we see it as very robust. Our integrators are extremely busy, and many are booked out months in advance. COVID-19 accelerated what were already healthy smart living adoption trends, fueling durable residential and commercial uptake that is continuing throughout this year.

The residential investment cycle is particularly strong. In this quarter, we saw an encouraging rebound in our commercial business as restaurants, bars and retail reopened and companies began to return to the office. We continue to carefully monitor the resurgence of COVID-19 and any potential impact on the business.

Mike will speak to the supply chain environment that's affecting the entire industry, but our company and our integrators have proven resilient in the face of challenging macroeconomic backdrops. We remain confident in our ability to successfully navigate any future uncertainty related to COVID-19. And I must say we salute our frontline employees, those in our local offices and our warehouses and our integrators who are going into homes and businesses every day for their ongoing dedication and sacrifice. They are our industry's heroes.

Longer term, our growth strategy has been to continue to affect the same playbook we've been doing for many years now. There are 5 key pillars to that growth strategy. One, continue to innovate with new products, software and technology-enabled workflow solutions for our integrators; two, continue to increase our wallet share with their existing integrators with existing products, which includes continuing to execute our omnichannel strategy, three, continue expanding our global integrator network with professionals focused on residential, security and commercial applications; fourth, develop new software services and revenue models.

We made, we feel like substantial progress against each of these organic growth pillars in the quarter. And with Access Networks and Parasol, we made strong progress against our fifth pillar which is to execute against strategic M&A.

As it relates to M&A, we view it as a core competency of ours and a strategic value driver for the business and for our integrators. We operate in a highly fragmented market, which lends itself to target rich, M&A landscape with our scale, our track record and now our access to capital, we've established ourselves as the acquirer of choice in the industry.

We expect, as a result of that, to continue to pursue disciplined accretive acquisitions that enhance our products, software and workflow solutions and expand into adjacent markets that allow us to best serve our integrator base. With that, I am going to turn it over to Mike Carlet, our CFO, who will go through our financial results for the quarter in greater detail and talk through our guidance. Thank you.

Mike Carlet: Thanks, John. Before I provide an overview of our financial performance, I'd like to provide a brief summary of our recent capital markets activities. As John noted earlier, in July, we conducted an initial public offering of 30,850,000 shares of our common stock at a price of $18 per share.

As part of this process, the underwriters partially exercised their overallotment option to purchase an additional 1,232,500 shares at the same price. This overallotment exercise resulted in Snap One, selling 1,170,812 additional shares and selling -- stockholders selling 61,688 shares.

In total, gross proceeds to the company before deducting underwriting discounts, commissions and other offering expenses were approximately $270 million. Of the approximately $248 million of net proceeds from the offering, we have used about $216 million to repay a portion of the term loan under our credit agreement plus accrued interest, and we expect to use the remainder of such net proceeds for general corporate purposes.

Now turning to our financial results for the fiscal second quarter. As John mentioned, net sales increased 34% to $253.3 million from $189.1 million in the prior year period. Our growth during the quarter was driven by strong overall demand across the business.

Both proprietary and third-party product portfolios grew over 29% with all product categories, geographic regions and markets experiencing growth in the quarter. Additionally, in the prior year quarter, our net sales were affected by declines in demand due to the impact of COVID-19.

Our net sales in the most recent quarter also benefited from the continued ramp of local branches with the opening of 5 additional branches between the end of the second quarter of 2020 and the end of the second quarter of 2021.

Net sales growth was partially offset by those supply chain challenges that John mentioned, resulting in stock-outs late in the second quarter of 2021. Our cost of sales, exclusive of depreciation and amortization increased 39% to $152.1 million or 60.1% of net sales, up from $109.2 million or 57.8% of net sales in the comparable year ago period.

The increase is cost of sales, exclusive of depreciation and amortization was primarily attributable to net sales growth and further impacted by increasing costs from suppliers and higher inbound freight costs.

Contribution margin which is a non-GAAP measure of operating performance increased 27% to $101.2 million representing 39.9% of net sales in the fiscal second quarter, up from $79.9 million or $42.2 million of net sales in the comparable year ago period. The increase in contribution margin was due to the increase in net sales. The decrease in contribution margin as a percentage of net sales was primarily due to accelerated growth of third party products, relative to the growth of proprietary products in the fiscal second quarter.

The increasing mix of third party product was driven by expansion of product and brand assortment to increase integrator stickiness, catalyzed by the execution of our omnichannel strategy of opening local branches. Third party product typically has a higher cost of sales exclusive of depreciation and amortization as a percentage of net sales relative to proprietary product.

The strategic expansion of our curated third-party product portfolio remains an important part of our value proposition. We seek to provide our integrators with a one-stop shop for their product needs while enhancing integrator loyalty and capturing incremental contribution margin dollars.

Our selling, general and administrative expenses increased 31% to $78.7 million or 31.1% of net sales, up from $60.1 million or 31.8% of net sales in the comparable year ago period. The increase in SG&A expenses was due to increases in variable operating expenses driven by higher sales volumes, while lapping of temporary cost reductions taken to mitigate the impact of COVID-19 in 2020 and continued investments to support strategic growth initiatives and costs associated with becoming a public company.

Our net loss totaled $1.1 million in the period compared to a net loss of $3.2 million in the comparable year ago period. The decrease in net loss was primarily due to the increase in net sales by a greater amount than related expenses. And the strong sales growth drove adjusted EBITDA, a non-GAAP measurement of operating performance, up 20% to $29.3 million, representing 11.6% of net sales compared to $24.4 million, representing 12.9% of net sales in the year ago period.

Adjusted net income, another non-GAAP measurement of operating performance increased 81% to $13.9 million or 5.5% of net sales, up from $7.7 million or 4.1% of net sales in the year ago period. The increase in adjusted net income was primarily due to the reduced net loss.

Finally, free cash flow, a non-GAAP measurement of operating performance was negative $9 million in the 6 months ended June 25, 2021, compared to $33 million in the comparable year ago period. We invested to build inventory to manage our supply chain, our payable terms returned to normalized levels following temporary extension we received last year in anticipation of the COVID disruption.

At the end of the fiscal second quarter, cash and cash equivalents was $35.9 million compared to $77.5 million as of December 25, 2020, our prior year-end.

And before I turn the call back over to John, I'll take just a few minutes to provide our financial outlook for the remainder of the year. Going forward, the company plans to provide annual guidance for net sales as well as adjusted EBITDA as we believe these metrics to be key indicators for the overall performance of our business. As we look at the remainder of the year, we continue to see strong demand for smart living technology. Against that backdrop, we are working diligently to combat the supply chain challenges that are impacting our business and the broader economy.

Our industry-leading inventory availability declined modestly during the second quarter and sporadic inventory stock-outs have accelerated into Q3. Our teams have been working tirelessly to take proactive measures to shore up our supply chain and our inventory positions. These actions have included advanced component sourcing, supplier diversification and increasing our inbound air freight to reduce transportation times.

Our diverse product portfolio and supplier base provides us some flexibility to navigate these challenges. So while our year-over-year growth rate will fluctuate as we lap the disruptions experienced last year due to COVID-19, we expect our 2-year organic net sales growth rate to remain consistent with Q2 and our long-term goal of low teens annual net sales growth, obviously, excluding M&A.

Now let's get to guidance. As a reminder, for 2021, our fiscal year ends on December 31, 2021 and includes a 53rd week. We're setting our fiscal year net sales guidance range between $985 million and $1 billion which would represent an increase of 21% to 22.8% compared to the prior fiscal year on an as-reported basis. We also expect adjusted EBITDA to range between $102 million and $109 million, representing an increase of 8% to 15.4% compared to the prior fiscal year.

Overall, we remain highly confident in the overall financial health of our business as well as our ability to sustainably grow for the foreseeable future. So that completes my summary. John, back to you.

John Heyman: Thanks, Mike. In closing, we'll just say we're quite pleased with our fiscal second quarter results and we're really energized by the tremendous opportunity in front of us. We believe our performance demonstrates; number one, the healthy ongoing demand for smart living solutions and number two, the resilience and diversification of our operating model, both of these things, notwithstanding the global supply chain challenges.

We believe we're in the early innings of global smart living adoption. And over the long term, we plan to continue broadening our distribution capabilities and workflow solutions, building compelling and innovative new products for the end user, while forging strong relationships with the integration community that serves them.

By empowering these professional integrators, to provide seamless experiences in an increasingly complex and expanding ecosystem, Snap One is positioned to drive sustainable growth for years to come. And with that, operator, we will take questions.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) And our first question will come from Erik Woodring of Morgan Stanley.

Erik Woodring: Congrats guys on your first quarter at the gates here. Maybe I'd love to touch on maybe some of the feedback that you've gotten from integrators following your price hike in early August, and whether you see yourselves needing to raise prices again?

And then the second part of that would just be, are your pricing increases fully offsetting the cost increases? Or any color that you could share there? And then I have a follow-up.

John Heyman: Yes. Thanks, Erik. Good to hear your voice. We announced effective August 1, an approximate 5% price increase given the cost increases we have seen both from our suppliers as well as things in the logistical space.

And we designed that to not just cover our costs, but to protect our margin. We announced it well in advance, 60 days because we -- it was important to us to give our integrators a heads up as it may affect the projects they had in flight.

And we -- there was plenty of other industry pricing activity that was going on. So I think integrators appreciated, number one, the fact that we gave them advanced notice. Number two, the price increase probably wasn't as drastic as some others.

And I think we've also built trust within the integrator community. We've also increased MSRP to allow them to protect their margins downstream. And given the demographic that our industry targets, we don't see that really impacting demand in any way.

So we're pleased with the changes and I -- our integrator community is not shy. I have not received a single comment on it.

And I guess your follow-up was, do we see anything other needed. And as we currently assess our cost structure, we don't feel like we need to do anything. However, this is the most dynamic environment that we've operated in, in some time.

And so we will do what it takes to protect our operating model, doing the same to protect our integrators model in terms of giving them the right kind of notice and being attentive to making sure the products remain affordable in the end market.

Erik Woodring: Okay. That's really helpful. And then the follow-up is just -- you mentioned integrators are booked months in advance. Can you just share kind of what that normal kind of backlog or lead time would look like in a normalized environment? Is it weeks? Is it -- just kind of frame what the current environment looks like compared to a "normalized environment".

John Heyman: Yes, I think as long as we've monitored this, we've always assessed integrator backlog more in the way of -- and this is a generic statement because we serve so many types of integrators, but more in weeks than in months. And right now, it's just really hard to get an integrators' attention. They are backed up. And so that gives us good visibility.

Operator: And next question comes from Paul Chung of JPMorgan.

Paul Chung: Congrats on the successful IPO. So I had a couple of questions. Just first up on the product mix of third-party products, which part of the portfolio did you kind of see strong relative demand? And how should we expect that mix, logistics costs and pricing to kind of impact the rest of the year? Just your gross margin outlook would be helpful.

And then what could revenues have been if inventories have been in a better availability in 2Q in your view? And have you seen that normalize for the most part in 3Q?

Mike Carlet: Paul, it's Mike. Thanks for the question. So to start, just from a growth standpoint, growth was strong across all categories. Most notably, our network and entertainment categories as people live, work and play more at home. And those products are seeing probably the strongest growth, but there's growth across the entire portfolio. As we think about where sales would have been if we didn't have the inventory shortfall that we had, it's -- we're seeing low single percentage points of impact on our top line revenue.

As we manage through the supply chain shortages, we're seeing an impact tens and a few hundred of our thousands of SKUs across the portfolio of product that we have. And so -- and it moves around on any given week, something comes in, something else goes out as you're going through the challenges that are out there and managing through it.

Paul Chung: Okay. Great. And then can you talk about the overall dynamics of your M&A strategy, particularly around top line margin. So in the example of Access Networks, can you quantify the top line uplift by leveraging your channel once you brought it in-house and also kind of the gross margin uplift as you bring that product in-house?

Mike Carlet: Yes. So Paul, Access Networks is a part of our guidance going forward. We're not separately breaking out their individual performance, but it's clearly included in our guidance as we go forward. They were already serving the same channel we serve. So the vast majority of access networks integrators were already Snap One integrators. However, by bringing Snap One, we're now exposing that product portfolio to a much broader base integrators. And so we do expect to see increases from a revenue standpoint as we introduce that product and just have the 16,000 integrators buying on the SNAP platform have that availability.

John Heyman: And just to add to that very quickly, I think the synergy we see from the revenue side of bringing their product to thousands of customers versus their hundreds of customers. We see that as a '22 event and that's primarily because we've got to ensure that the supply chain can react to that type of demand. So it's not just a matter of buying them and putting their product on the shelf.

Paul Chung: And then lastly, will you be providing integrator count with respect to revenues and international and RMR split? That's it for me.

Mike Carlet: I think international and domestic is split out in the Q. And we -- I don't have those in front of me, but you can see them in there. We are looking at further revenue disaggregation as we go forward, but that's the only revenue disaggregation that we have today.

Operator: Our next question comes from Stephen Volkmann with Jefferies.

Stephen Volkmann: Maybe just a quick follow-up on one of the earlier questions relative to the price increase. Have you historically seen like a pre-buy or maybe things are just too tight for that to happen. I'm just trying to think about the cadence of third and fourth quarter relative to sort of the price cost.

It feels like the fourth quarter will be fine. Maybe there's a little headwind in the third quarter. Just any color there.

John Heyman: Yes. We -- because we announced 60 days in advance, we can see and because we know what our normal patterns are we can see the last couple of weeks of July, right before the price increase, a small amount of build-out and that gets amortized very quickly in the first couple of weeks of August. Remember, our integrators, the vast majority of them don't have warehouses to store product. And so it is a dynamic, but it's not material in the business.

Stephen Volkmann: Okay. Great. And then maybe just a quick comment on cash flow. I think you said you were building a little extra inventory, which definitely makes sense, I guess, in this environment. Do you then liquidate that as we get towards year-end? Or is that something that we should just sort of straight line going forward?

Mike Carlet: Yes. We're definitely still a little bit under inventoried. If we go back to last year when COVID first hit, and we were looking out and trying to figure out where demand was going to be, we definitely were sensitive to our inventory balance.

And then we've had a great last 12 months and have been chasing inventory with the supply chain challenges that are out there. We've been investing in inventory, and we've got a little bit more to go there. So it won't be liquidated, but it shouldn't grow significantly outside of our normal revenue growth.

So as we said, we expect inventory to grow roughly in line with our inventory growth on a go-forward basis.

Operator: Our next question comes from Chris Snyder with UBS.

Chris Snyder: So at least by my math, guidance into the back half assumes very little, if any, increase in activity relative to Q2, once we account for the 5% price increase, the extra week in Q4 and the access network acquisition. So I guess my question is, does guidance assume supply chain disruption picks up into the back half? You guys talked about inventories running a little bit low. Or is integrator activity capped at the levels we saw in Q2, just because this is a labor-intensive industry, and there's trouble hiring across the economy.

Mike Carlet: Definitely the former, Chris, as we're looking out there, we see the supply chain challenges. They did accelerate into the end of Q2, and we're still seeing those today.

And so we've taken an approach that we want to be conservative as we think about the logistical and supply chain challenges that are out there. And so because of that, while we're still seeing great demand sensors out there. We've moderated our expectations about our ability to meet them. Primarily in Q3, we do think we'll moderate back going into Q4.

We're watching it closely, but we want to make sure we're going into this with eyes wide open. It's still a little bit murky out there. And as we look out there and when exactly it's going to get back to mobile times, we're just being conservative in our guidance as we look out the rest of the year and manage that supply chain challenge.

Chris Snyder: I appreciate that. And then I think you guys called out maybe a low single-digit percentage point impact to revenues in Q2. So it sounds like the embedded impact into Q3 is above that. And then I would also -- can we get some color on the increased costs incurred as it relates to the supply chain impact? Because obviously, this is impacting revenue, but you guys called out advanced component sourcing, new suppliers, more air freight, all of which sounds like it drives OpEx higher. Any color there on either what was experienced in Q2 or kind of what's baked into the rest of the year?

Mike Carlet: Yes. Thanks, Chris. So definitely, it's going to have a bigger impact on Q3 than Q2. If Q2 was low single digits, Q3 is going to be mid-single digits from our standpoint. And really the second half of the year is our expectation on that supply chain pressure. And again, we expect it to moderate in Q4 and get closer to normal by the end of the year, but it's something we're watching closely.

As far as the cost pressure we're seeing, it's really in 3 areas. One is on commodity pricing. We've all seen that. That's moderating a little bit, but we're seeing those inputs as an issue. Labor is the other one. So at our factories, we're definitely getting conversations from our proprietary product contract manufacturers and JDM partners on the prices that -- the cost pressure they're feeling and looking to pass that along.

And then we all know what's going on with logistics in the freight rates that are out there, the ocean transportation, airfreight are all tight right now. And so we're seeing that. That should moderate going into next year is the expectation. And so the 5% that we passed through really is meant to overcome all that and maintain our margin rates, as John said.

Operator: Our next question comes from Ketan Mamtora of BMO Capital Markets.

Ketan Mamtora: First one, maybe John or Mike, can you talk a little bit about your M&A pipeline? And what areas are most interesting to you?

John Heyman: Yes, sure. I think we have been -- since we got the IPO done, and don't forget we did access earlier this year. I think we've been working now on kind of refreshing the pipeline. I think there's two areas that are of primary interest to us. One is continuing to do things that expand our reach and our distribution capabilities.

And I would point specifically to security and commercial as a part of those. And secondarily, I would point to kind of the international market, but that's distant from security and commercial.

And then the other piece are product opportunities that could have played in those markets, security and commercial specifically, but also opportunities for us to continue to consolidate our existing position in the residential technology market, translate with our 3P margins into 1P margins and make our reach available to those product companies who don't necessarily have it.

So those are the 2 primary areas for us. And then if we -- as we continue to expand our distribution capability inside the U.S., if we can pick up small distribution companies that already have a culture similar to ours in terms of serving the integrator and have presence in a locale that we're not in, I think we'd be very interested in making them part of our family.

Ketan Mamtora: Got it. That's very helpful. And then my follow-up would be around your brand strategy. Can you just remind me kind of how you guys are targeting kind of the number of branches that you are going to open as we head into 2022. Not asking for sort of specific numbers, but just sort of getting a sense of how you guys think about the opportunity there.

Mike Carlet: Yes. So right now, as John said, we're 27. We expect to open another 3 or 4 for the remainder of this year. And our range of openings, I would say that we aspire to open about 10 a year. And we feel highly confident we'll open 5 or 6.

And so it all becomes a matter of capacity and timing and finding the right location, all those things, but somewhere between 6 and 10 locations, I think, is how we think about it. And we'll always push for the higher number and model the lower number.

Operator, any more questions?

Unidentified Company Representative: Valerie, are you there?

Mike Carlet: Okay. So we've lost our operator. For anybody on hold, we're trying to figure out how to figure out some questions if she doesn't come back. So just stand by, please.

John Heyman: Everyone, this is John. Inevitably on our first conference call, something has gone wrong. We've lost our operator, and only she can unmute the line. So those of you who have questions, we'll take them after the meeting. I want to just say thanks for joining us today. It's really...

Operator: Pardon me, sir. This is Andrew. I'm taking over for Valerie. Are we -- should we go into Q&A now?

John Heyman: Sure. If we got more questions, let's go.

Operator: Yes, we do. Okay. Our next question comes from the line of Ryan Merkel with William Blair.

Ryan Merkel: I'm still here.

Mike Carlet: Sorry about that.

Ryan Merkel: No problem. It's very unfortunate on your first call, as you said. But -- so my first question is on gross margin. How should we think about the second half. You have the price increase out there. Should gross margin lift sequentially from the second quarter into the second half?

Mike Carlet: So we've set the price increase to offset the cost pressure we're feeling. And obviously, some of that costs came through a little bit earlier in the year and some of it is coming through now. And so as it blends out, we'll see a slight lift early in Q3. But other than that, I wouldn't be modeling any significant changes in our margin rates going forward.

Ryan Merkel: Got it. Okay. And then for my second question, just maybe an update on traction in the commercial and security markets, if you would.

John Heyman: Well, they both have grown nicely. I think we've seen accelerating growth. As we kind of measure those channels security was a bit below our overall growth rate at 26%, commercial was up over 50%, 5-0-.

So that shows the bounce back we're starting to see in the commercial market. As we all know, nobody was going into commercial spaces in the second quarter of 2020. So we are launching products.

We are continuing to drive the same growth strategies we are in residential. -- and we're really pleased with what we're seeing.

Operator: Your next question comes from the line of Ketan Mamtora with BMO Capital Markets.

Ketan Mamtora: I'll take the second opportunity if I get. So maybe just talk a little bit about the Snap and Control4 sort of the ERP platform consolidation that you are planning? And kind of what is the target there?

Mike Carlet: Sure. So when we executed the merger of the companies just about almost exactly 2 years ago, Control4's e-commerce platform and the Snap One's e-commerce platform still are out there separately and our integrators are transacting separately. We're in the process of converging them.

There's 2 steps to that. First is converging the whole loyalty programs across all of our platforms, including those e-commerce platforms and our omnichannel local stores. and we expect to have that done by the end of the year.

And then from there, we'll be merging the actual e-commerce platform between Snap One and Control4. And sometime early to middle of next year, we would expect to have those collapse into one. So integrators will be only transacting on one platform, not -- instead of 2.

Ketan Mamtora: Got it. And then if you think about kind of CapEx for 2021 and sort of what is the right framework to think about sort of 2022?

Mike Carlet: Other than the relocation of our Draper headquarters, that lease has expired and we're moving our Salt Lake City headquarters. The ratio of CapEx to revenue should remain very consistent in 2022 with where it's been in 2021 and historically, it's a little bit over 1% is our typical CapEx rate and wouldn't expect that to change significantly.

Operator: Your next question comes from the line of Adam Tindle with Raymond James.

Adam Tindle: Okay. I've had plenty of time to think about this guy. Yes. Congrats on the results and IPO. So John, I did want to touch on -- you've obviously got a very healthy core residential environment that you're in right now. But as I think about the back half of this year, we've got catalyst on top of it with C4 OS for commercial, I think, planned to come out. You gave us the commercial growth rate, but maybe you can take a step back and touch on the overall commercial opportunity. Maybe touch on the progress on that OS release and any early indications from dealers on interest levels?

John Heyman: Sure, Adam. I think we became interested in this market because we started to see commercial integrators coming to us just for the superiority of the products without really any devoted effort to go out and market to these integrators. And now the business has grown pretty significantly.

So we've become much more strategic about it. And I think before we could get serious about it, we had to ensure that we had the product capability in all the areas because I think what's made us really unique inside the resi industry has been the combination of the workflow solutions that residential integrators value.

But also, as we talked about with the brand analysis, we feel like we've got the best products and the best software platforms in the industry. We don't have the best products and platforms yet in the commercial industry. And so what our teams have been doing is investing in those. And so in some areas, those are -- have been easier to do. We work with our partners in Asia and have been able to do things around how many ports, for instance, networking switch has.

And we've been able to not revamp, but add features and functionality to oversee that are required for commercial integrators. So we're managing across many different locations for a single customer. And what we've been lacking there is what we would call the center plate product around Control4 for that environment.

And the first release of that product is going to be in September, and we're really excited about it, and we're getting good feedback on it. It's in beta now. And that will be a journey. As we -- control system in a residential environment is very similar, almost regardless of what home you put it in. Control system in a commercial environment because there are so many different types of commercial environments varies.

And so we'll continue to enhance that system with features and functionality and continue to round out some of our other product lines. So we feel like we're at the beginning, but it's a business that today is significant tens of millions of dollars for us. And we're really optimistic in getting good reception on the products from both commercial integrators, but also our residential integrators who may have been really busy with residential implementations over the past year, but traditionally have seen commercial applications, be as much as 30% of their business. And we are sure that as the commercial business continues to return, they'll be there along with commercial integrators to serve that. Sorry for the long-winded answer.

Adam Tindle: No, that was very helpful. And obviously, control is complex, but chance to be a pretty big differentiator. So definitely wishing you best of luck with that initiative. Just as a follow-up, maybe for Mike.

On seasonality, in covering Control4 years ago, we kind of count on sort of a steady revenue build throughout the year with Q4 typically being largest by revenue. And I'm wondering how to think about this year for Snap, what could be different because traditionally, you'd have maybe Q3 looking -- sort of like Q2 revenue dollars with the balance in Q4 and being a little bit higher.

And what could be potentially -- is that the right way to think about it? Or what could be different this year?

Mike Carlet: Yes. Good question,. So I think, generally, when we look at seasonality in our business. Our sales are generally highest in Q2. That's when our outdoor solutions, outdoor audio-video surveillance, access points come into season, viewers stock up on those products sometimes or that's when those jobs are starting to ramp up.

Sales continue to be strong in Q3 and then into Q4 due to consumers' desire with home projects, part of Thanksgiving, Christmas holidays. We do tend to sell a bunch of TVs at our local omnichannel stores, and there's always the typical TV Black Friday holiday type of sales spike out there.

And so that's how we generally think about Q1. We'll see very, very modest decreases in sales on an average per day basis from what you see there. But the seasonality across our portfolio should be significantly less than what you used to experience with Control4.

Operator: Your next question comes from the line of Keith Hughes with Truist.

Keith Hughes: A question on commercial. Talked about several times in this call. Could you just talk about what kind of commercial jobs that you -- the types of job inadvertently been doing that you think you could serve now and in the future as you ramp this up? And what would be areas you couldn't serve?

John Heyman: Well, I think right now -- good question. Right now, what we're focused on is what I'll call smaller applications that we would fit into what we call the design and build category. What we're not doing is large office towers where specifiers and architects have been hired and RFPs are being put out to various product companies and/or integrators.

Those are not the projects we're typically going after. Think restaurants and sports bars. The local lawyer's office or accountant's office where they need network and they need a surveillance system to look at the property conference rooms that will have sound bars and speakers and microphones and so forth in them. That's what we're focused on right now, and that's a very big market.

Operator: Thank you. I would now like to turn the call over to management for any closing remarks.

John Heyman: Okay. I started this earlier when we lost the operator. So I'll try it again. First of all, thanks again for joining us this afternoon. It is a really exciting time for the company. I just want to take a moment and thank the 3 groups of people.

Number one, our dedicated employees who have been working so hard to generate the results during really trying times in the country. Number two, our network of 16,000 integrators and 100,000 plus people who work for them who've been going into homes throughout this COVID crisis and making those homes more connected, safer and more enjoyable.

And I want to thank the investors, you guys who are taking time with us today, but who also supported us in our IPO. And we will work hard to continue to deliver results for all of you. So with that, I'll turn it back over to the operator, and we will speak with you guys after the third quarter.

Operator: Thank you for joining us today for Snap One's Fiscal Second Quarter 2021 Earnings Conference Call. You may now disconnect.