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Corporate Speakers
- Eric Steele; Snap One Holdings Corp.; Senior VP of Finance & VP of IR
- John Heyman; Snap One Holdings Corp.; CEO & Director
- Michael Carlet; Snap One Holdings Corp.; CFO

Participants
- Erik Woodring; Morgan Stanley; Research Associate
- Paul Chung; JPMorgan Chase & Co; VP & IT Hardware Analyst
- Christopher Snyder; UBS Investment Bank; Analyst
- Keith Hughes; Truist Securities, Inc.; MD
- Unidentified Participant; Raymond James;

PRESENTATION

Operator^ Good afternoon. Welcome to Snap One Holdings Corp.'s Fiscal First Quarter 2023 Earnings Conference Call. (Operator Instructions)

I would now like to turn the call over to Snap One's Senior Vice President of Finance, Eric Steele. Sir, please proceed.

Eric Steele^ Thank you. Good afternoon, and welcome to Snap One's fiscal first quarter 2023 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 inherent risks and uncertainties, including those identified in the Risk Factors section of our latest annual report on Form 10-K 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 time and date of this broadcast, May 9, 2023. 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. In addition to the webcast, we have also posted a supplemental earnings presentation accompanying these results, which can also be found on our Investor Relations website.

I will now turn the call over to our CEO, John Heyman. John?

John Heyman^ Eric, thank you, and thank you to everyone for joining us this afternoon. To begin today's discussion, I'm going to give some quick company background. I'll follow that by a review of our recent performance. I'll turn it over to Mike Carlet, our CFO, and he'll discuss the financial results for the quarter in more depth as well as provide our outlook for the remainder of the year. After that, I'll share some closing remarks, and then we'll open the call for questions.

All right. Let's get started. As a reminder, here at Snap One, we provide a smart living platform that empowers professional integrators to deliver joy, connectivity and security to discerning residential and commercial customers on a global scale. As a leading distributor to these integrators, we work with our growing network of approximately 20,000 professional do-it-for-me integrators to distribute our proprietary and third-party products through our e-commerce portal and local branches. We call these integrators partners because we invest in their success and expect them to invest in ours so that we can jointly deliver the experiences our customers love.

As part of these investments, we support our integrator partners with proprietary software platforms and workflow solutions to allow them to successfully serve the customers across the project life cycle. We believe the smart living opportunity is large and it is durable. Secular tailwinds, including technology adoption, software enablement, housing construction and small business formation will continue to propel the industry forward. Many end users will seek professional help to install, integrate and support the technology they use. At Snap One, we aim to provide our partners with these right products, software, services and workflow tools to capitalize on the smart living opportunity.

Let me comment just briefly on our recent performance. Our team has delivered strong first quarter results in an uncertain environment, highlighting the resiliency of our business model and that of the partners we serve. In our first quarter 2023, we generated $252 million in net sales and $22.7 million in adjusted EBITDA. Overall, the demand environment remains steady. Our partners continue to stay busy as they work through healthy backlogs in their own businesses, though they do remain cautious as to economic news. As you may expect in the current macroeconomic climate, we're hearing some cautiousness for more budget conscious end consumers for entry-level projects and production building has slowed, but we're pleased to report that the high-end residential and commercial markets remain resilient.

Our diversified business model and product portfolio allow us to serve integrators across a variety of end markets, supporting our partners' ability to pivot projects and adapt to the

current environment. Finally, we've also seen the normalization of productivity in the channel after the tremendous project velocity over the last several years. We believe this is a natural rebalancing to sustainable levels. Last quarter, we noted that inventory in the channel appear to have peaked towards the end of the second quarter of 2022, and we have since seen ongoing signs of destocking. This channel inventory destocking continued in the first quarter, although at a slower pace than we expected.

Importantly, while the destocking remains a year-over-year growth headwind after adjusting for the estimated channel inventory impact, we delivered year-over-year growth of approximately 5% in the first quarter. We believe this positive adjusted growth rate compares favorably to the broader industry, reflecting our continued market share gains. As I think about the first quarter performance and look ahead to the remainder of the year, we remain focused on 2 strategic initiatives for the year. One, launching new products and services, along with key sales and marketing initiatives to earn a higher share of our partners' wallets while improving the end consumer experience and the profitability of our partners.

And two, expanding our operating margins through several key programs centered on our production costs and operating expenses. I'll take a few minutes and address both in the context of our first quarter results and the rest of the year outlook. I'll start with share of wallet. We see significant opportunity to expand our existing partner relationships following the COVID and supply chain periods of uncertainty. We believe we are well positioned to attack this growth opportunity with a multi-pronged approach, spanning products and software, go-to-market focus and service excellence.

First, products and software. We successfully delivered on new product innovation and enhanced software platform capabilities in the first quarter, including the introductions of exciting new solutions across outdoor audio and lighting, control, surveillance and networking. We're particularly excited about Halo, our new family of Control4 remotes, Araknis wireless access points, which enable enhanced connection speeds with Wi-Fi 6 technology, Vibrant Linear Lighting, which provides a fully immersive lighting experience, the all-new x20 family of high-quality Luma surveillance solutions, and our 2023 Consumer Electronics Show, Outdoor Living Product of the Year -- Year -- excuse me, Award Winner, Episode Radiance, which builds on our suite of outdoor entertainment solutions.

These exciting launches strengthen our product portfolio and set a strong foundation for a robust pipeline of continued innovation from Snap One. Importantly, many of these new products will also drive upgrade opportunities for our installed base of end customers. Shifting to the go-to-market and complementing our product portfolio, we continue to refine our go-to-market strategy to drive share of wallet growth. We took several important steps forward in the first quarter, including one, we have continued to convert our e-commerce transacting integrators to a single portal in order to drive efficiencies in our business, save our partners' time and money and allow us to drive marketing programs with higher efficacy while exposing them to better products. Two, we've

leveraged our loyalty program to consolidate our targeted incentive programs for our partners.

These programs are designed to drive product category and ecosystem adoption and to strengthen our partners' overall relationship with Snap One. Three, we expanded our strategic omnichannel presence by opening a Fort Myers, Florida location, bringing the total number of North American branches to 41 at the end of the quarter. We intend to continue opening local branches to serve our partners in their communities. And finally, we reorganized our sales team structure to roughly triple our active partner coverage by moving more towards an inside sales model, we believe this new formation will enable us to drive efficiency, focus and results.

And finally, the final pillar is service. Our compelling value proposition is underpinned by award-winning service capabilities. In the first quarter, we were humbled to earn 14 2023 CE Pro Quest for Quality Awards across 22 categories, reflecting our service excellence as voted by professional integrators. We thank our partners for their vote of confidence in Snap One and to our team members for their exceptional service.

Our second strategic initiative is driving operating margin expansion. The world has been anything but normal the past 3 years. With the uncertain macro backdrop in mind, we are continuing to review our long-term operating plan to prioritize investments in areas that we believe will position us for sustained long-term growth, while curtailing spend in other places. Therefore, we have constructed an operating plan that strives to optimize our cost structure and reflects a heightened focus on delivering strong profits and expanding operating margins.

A few points here. Number one, our first quarter financial results benefited from the excellent work our supply chain team has done to drive lower supply chain and input costs and strengthen our contribution margin rate. They have driven improvements in such areas as freight, logistics, commodities and componentry ahead of our expectations.

Two, we are working on several additional initiatives to drive continued upside on contribution margin rate as we move through the year and realize the full benefit of a cost environment that is easing. [Number three], following a modest workforce reduction of about 3% completed in the first quarter, we remain focused on disciplined cost management while focusing our investment activity on programs that drive efficiency and optimize productivity. Collectively, we believe our improving contribution margin rate and scaling cost base have us on track with our operating margin expansion plan for the year.

Before I comment on our outlook, I want to first comment on Jeff Hindman's departure from the company. Jeff has done some great things for Snap One over the past 7 years. An opportunity came to him to become the CEO of a company outside of our industry. Thankfully, Jeff has built an amazing team in sales and marketing, and that will effect a smooth transition. With Jeff's departure, Ryan Marsh, our EVP of Sales, will report directly to me as with -- as well Ashley Swenson, our SVP of Marketing. We have full

confidence in our existing leadership's ability to drive our growth strategy in the years ahead.

And now let me comment on our outlook and then turn it over to Mike. Overall, our full year 2023 outlook remains solid as we seek to move past the channel inventory destocking headwind, drive operating margin expansion and enhance our liquidity position. We are maintaining a pragmatic view of top line performance given the persistent macroeconomic uncertainty and channel inventory destocking headwind in the short term. However, our strengthening contribution margin rate and disciplined cost structure management provide us with improved visibility into our profitability outlook for the year. With that in mind, we are tightening our net sales and raising our adjusted EBITDA guidance for 2023, which Mike will discuss in further detail.

We believe the smart living adoption industry -- smart living adoption is going to continue to grow. The central role of the integrator in providing holistic solutions is durable and our competitive differentiation will enable us to continue to prosper in a dynamic macro environment and propel our long-term success.

And with that, I'll turn it over to Mike Carlet, our CFO, to discuss the first quarter results and '23 outlook in greater detail. Mike?

Michael Carlet^ Thanks, John. Now before I get into the specifics of the financials, let me just start at a high level to provide some context on our financial performance and outlook. As we approach 2023, we had a growth mindset in our planning, but we also had a pragmatism around the softer economic environment, the channel inventory dynamics, and we factored all of that into our volume assumptions.

Given this mindset, we focused on a variety of actions to drive contribution and operating margin improvement inside the business, especially as the headwinds of COVID and the supply chain have begun to subside. So notwithstanding the current macroeconomic uncertainty, we are continuing to invest across the business for growth, given the secular smart living tailwinds we continue to see. These investments span new products, go-to-market activities and important internal technology investments that will help us operate more efficiently.

We're funding these investments by deprioritizing spend in other places. Our first quarter results validate our approach. Our team has accelerated some of our cost efficiency initiatives and remains focused on further improvements. Our new product launches are already paying dividends, and we believe they are helping us gain share. These products and our pricing strategies are adding value to the end consumer, allowing both us and our partners to differentiate on performance rather than price. We're pleased with the resiliency of our business model and the strong execution of our team in this tough environment.

So now I'll turn to our financial results for the quarter ended March 31, 2023. Net sales in the fiscal first quarter decreased 9.2% to $252 million from $277.4 million in the

comparable year ago period. The anticipated decrease in net sales during the quarter reflects the channel inventory destocking headwind that John mentioned earlier. We estimate that approximately $30 million of channel inventory sell-in occurred in Q1 of 2022 and approximately $10 million destocked in Q1 2023, representing a year-over-year top line headwind of approximately $40 million. After adjusting for this estimated channel inventory impact, we delivered year-over-year net sales growth of approximately 5% in the first quarter.

Let's talk a bit more about this channel inventory and our expectations. As discussed last quarter, we believe that channel inventory began to build in the middle of 2021 and peaked at over $100 million by the middle of 2022 before beginning to unwind. Inventory destocking continued in Q1 of 2023, although at a pace that's a bit slower than we originally anticipated. At the end of Q1 '23, we estimate approximately $65 million remains of channel inventory over and above our typical carrying levels of our partners. As we survey our partners, we're hearing that integrators may be adapting to a new normal level of higher inventory on hand, which would decrease both our time to normalization as well as our overall destocking headwind.

With this in mind, the range of practical outcomes is broad, especially with the appearance of a slowing rate of destocking over the last 3 quarters. As of now, our models and guidance continue to assume the full approximately $65 million destock will continue this year and end by the end of 2023. Contribution margin, a non-GAAP measurement of operating performance increased 1.1% to $106.2 million, representing 42.1% of net sales in the fiscal first quarter. This was $105.1 million or 37.9% of net sales in the comparable year ago period.

Contribution margin as a percentage of net sales increased due to the cumulative impact of our price adjustments enacted in response to supply chain and input cost inflation, which has begun to ease both through our efforts and through the general macroeconomic conditions. Selling, general and administrative expenses in our fiscal first quarter increased 8.4% to $93.8 million or 37.2% of net sales from $86.5 million or 31.2% of net sales in the comparable year ago period. The increase in SG&A expenses was primarily attributable to increases in fair value adjustments of some contingent value rights, equity-based compensation, severance costs, continued long-term strategic growth investments, costs absorbed from recent M&A and new local branch investments.

So all these increases were partially offset by a continued focus on cost controls and operational efficiency initiatives. Our net loss totaled $14.5 million in the first quarter compared to a net loss of $2.3 million in the comparable year ago period. Adjusted EBITDA, a non-GAAP measurement of operating performance totaled $22.7 million or 9% of net sales in the '23 first quarter compared to $23.6 million or 8.5% of net sales in the comparable year ago period. This change in adjusted EBITDA on both a dollar and rate basis was primarily attributable to contribution margin growth offset by those increased SG&A expenses.

Adjusted net income, a non-GAAP measurement of operating performance decreased 68.6% to $3.4 million or 1.3% of net sales from $10.7 million or 3.9% of net sales in the year ago period. Free cash flow, another non-GAAP measurement of operating performance totaled negative $11.8 million in the fiscal first quarter ended March 31, 2023, compared to negative $26.3 million in the comparable year ago period. The increase in free cash flow was primarily attributable to a decrease in net cash used in operating activities, offset by an increase in capital expenditures.

Capital expenditures increased year-over-year, primarily attributable to the onetime build-out of our new corporate office in Lehi, Utah and capitalized costs related to growth initiatives. Net cash used in operating activities for the fiscal first quarter ended March 31, '23, was negative $2.6 million compared to negative $23 million in the comparable year ago period. The primary driver of our year-over-year decrease in net cash used in operating activities was due to a $26.2 million net decrease in cash used for inventory compared to the prior year. This reflects our continued efforts to rebalance our inventory levels.

At the end of the fiscal first quarter, we had approximately $74.7 million in total liquidity, including cash and cash equivalents of $34.5 million and undrawn revolver capacity of $40.2 million. Since the end of Q1, we've continued to see improvement in our liquidity position as anticipated. We continue to thoughtfully work down our inventory levels and remain on track to reduce inventory to the previously communicated $270 million target level by the end of the year.

Now before I turn the call back over to John, I'll take just a few minutes to provide our financial outlook for the rest of fiscal year 2023. As a reminder, Snap One provides annual guidance for net sales as well as adjusted EBITDA as we believe these metrics would be key indicators for the overall performance of our business. Our fiscal '23 guidance considers our strong first quarter as well as our ongoing expectation that market uncertainty will persist throughout 2023. As such, we are tightening our full year net sales and increasing our full year adjusted EBITDA guidance ranges from our previously published outlook.

We expect net sales in the fiscal year ending December 29, 2023 to range between USD1.06 billion and USD1.09 billion, which would represent a decrease of 5.7% to 3% compared to the prior fiscal year on an as-reported basis. We expect adjusted EBITDA to range between USD110 million and USD118 million, representing a decrease of 3.6% to an increase of 3.4% compared to the prior fiscal year on an as-reported basis. Our adjusted EBITDA guidance reflects our commitment to driving incremental adjusted EBITDA margin expansion in 2023. We expect to achieve this through contribution margin rate improvement as supply chain and input cost fees as well as through disciplined operating expense management.

As noted previously, we are already outpacing our expected contribution margin rate expansion and anticipate continued strength in this area in the coming quarters. So as we think about our quarterly trending in '23, from a top line perspective, we continue to

anticipate a return to positive year-over-year growth in the second half of the year as we execute our growth strategy and work through the channel inventory destocking. On contribution margin rate, we saw better-than-expected results in the first quarter. While we originally anticipated an acceleration in contribution margin rate over the course of the year, our team worked diligently to extract costs from the supply chain more quickly to deliver more of that margin expansion in Q1 of '23.

Therefore, we expect this contribution margin strength to continue with an opportunity for continued outperformance. From an adjusted EBITDA perspective, we expect Q2 '23 adjusted EBITDA margin to trend similar to the comparable prior year period and to modestly improve on a year-over-year basis through the second half of '23. One final update before I pass the call back over to John. As a reminder, last year, Snap One's Board of Directors approved a stock repurchase program that authorized potential repurchases of up to $25 million of our common stock from the date of approval, which was May 12 of '22 through the end of '23.

As of March 31, 2023, we had repurchased approximately 296,000 shares of our common stock at an aggregate value of approximately $3.1 million. Consistent with our capital allocation policy, we will continue to prioritize the following in order. First, our balance sheet strength; second, our organic growth investments; third, accretive M&A opportunities that present themselves; and fourth, our opportunistic share repurchases.

That completes the summary of our financials. I'll turn the call back over to John for additional commentary. John?

John Heyman^ Mike, thanks. A few closing thoughts before we hit Q&A. Number one, we remain quite bullish around our growth aspirations and longer-term operating model. And we believe we're making the right decisions to best navigate our current market reality. For 2023, we have confidence in our operating margin expansion plan and have already started returning to our favorable contribution margin rate trajectory as costs related to the supply chain continue to alleviate.

Second, we remain committed to our overarching strategy. This is founded upon new proprietary product launches, growth in adjacent markets such as commercial and security, additional local branch offerings -- openings, software investments, all in support of our partners to capitalize on the opportunity in front of us and them. Even in an uncertain operating environment, we continue to strive to be the one partner that our integrators trust to support and grow their business.

And third, as I've said before, we believe that all homes and all businesses will become smarter over the next decade, driving demand for the types of experiences we offer today and those we can only imagine in the future. We've invested in scale and platforms that will drive better solutions for the end customer, more capacity for the integrator and growth for Snap One in a way that increases operating margins over time. Overall, we believe our actions at the close of last year and so far this year have prepared us to

succeed in the present environment will also position us for longer-term sustainable growth.

And with that, we'll open it up for Q&A.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) And our first question comes from the line of Erik Woodring with Morgan Stanley.

Erik Woodring^ John, I wanted to dig into a comment that you made, and you talked about kind of some incremental low end or some incremental weakness at the low end of the market, but resiliency at the higher end. And so I guess my 2-part question is, one, does weakness at the lower end, is that historically an early indicator for anything at the high end or is that reading too much into it? And then two, I know most of your projects are at the higher end. But can you maybe just give us a sense for what kind of exposure you have to any of that low end, if at all? And then I have a follow-up.

John Heyman^ Well, I think good question, Erik. I think -- look, I think the exposure we've had on the low-end side has been more around security and production building. And we're fortunate that we're a fairly recent entrant into that space, but it's something that certainly, you can see in our numbers as we monitor the business that, that's been a bit weaker, in large part because as we all know, production build has slowed. And so we have some integrators that focus on that market. So that's number one.

Number two, we don't believe in kind of looking at the trends around kind of higher-end homes that it really creates any sort of issue for us. And the reason for that is if you look at the number of homes even today being built on the higher end. And if you look at the capabilities of those integrators and their ability to pivot to think -- to places like commercial establishments, where they're working with similar technology in restaurants and bars and conference rooms and things like that, that's where we see the resiliency of the model because integrators shift their capacity. So I don't think it's a leading indicator. But I think as Mike couched our guidance, we're being watchful about that, and we're managing accordingly from a cost standpoint. Mike, would you add anything to that?

Michael Carlet^ No, John, I think those were right on. And again, I think the higher-end still appears to be very resilient, and we feel great about what's happening there. But it's an uncertain world out there, and we're trying to be prudent as we think about how do we spend in an uncertain world.

Erik Woodring^ No, that totally makes sense. I appreciate the color from both of you. And then, Mike, maybe to follow up on some of your comments on contribution margin. Obviously, very strong 1Q. I think last quarter, we talked about sequential improvements in contribution margins from 2Q to -- into 2Q and then into 3Q. But the comments you alluded to, somebody implied maybe you pulled forward some of that improvement. So I just wanted to maybe parse out and get a better understanding of maybe how to think about the seasonality of contributions as we move from the strong March quarter into the

rest of the year or if we're just seeing across the board uplift? That would be really helpful. And that's all for me.

Michael Carlet^ Thanks, Erik. Yes. Great question. So we definitely saw some great work from our teams to bring in some of that opportunity that we thought we'd see later in the year into the first quarter. So we still expect some improvement off of where we are in Q1. I think Q1, our contribution margin is just above 42%, 42.1%, I think is the number.

And we expect it to go up a little bit in Q2 and Q3 from that number. But given that we pulled it in quite a bit into Q1, the quarter-by-quarter sequential improvement won't be what we expected, but we still feel great about where we're going to land and it's still in line with expectations. And I think as John mentioned, I think we feel like there might be some upside from there that the teams continue to work on and identify opportunities to continue to drive that forward.

Erik Woodring^ Perfect. Congrats on a good quarter.

Michael Carlet^ Thanks, Erik.

John Heyman^ Thanks.

Operator^ One moment for your next question. And your next question comes from the line of Paul Chung with JPMorgan.

Paul Chung^ So I wanted to ask on the pricing kind of versus volume dynamic in the quarter. How did those variables kind of trend? And what are your expectations for the balance of the year? I know you had some pricing benefits, do those kind of ease a bit as we move through the year? And then across products where you're seeing some nice demand momentum for the full year? And I have a follow-up.

Michael Carlet^ Sure. I'll take the first part of it, John, and if you want to take where we're seeing momentum from a product standpoint, feel free to jump on to that one. But yes, great question, Paul. I think as we think about Q1, as expected, the first thing is the inventory in the channel headwind. That was almost 14% when you think about that $40 million swing between $30 million in last year and $10 million out this year. So if you think about a 9% year-over-year sales decrease, the first thing we look at and say, well, about [14%] of that is just the math around that $40 million coming out.

And then as we disclosed, we did price increases of 6% last year in February and 9% last year in June. And so you sort of take those, look at the quarterly impact, and that's about a 7% impact in the quarter from pricing. And so everything else is volume or some smaller bits and pieces. But generally, everything else we'd say is the organic volume underneath it, and it's flattish to down 1 point in the quarter. And as we think about our performance for the full year, as John talked about, and I think we mentioned, we think

that, that underlying demand of flattish is where we expect the year to remain. We're not assuming we're going to get better than that this year.

We think secularly long-term, there's still lots of months of upside. It's about where we think we're going to be for the long-term. But as we're taking a prudent view this year, we're just thinking that's going to remain around the flattish standpoint. Obviously, that pricing benefit from last year's 6% February increase and 9% June increase will fall off as we lap those. So by the time we get to Q4, the pricing impact is almost 0. We only did a very small price increase this year. And so you can just think about that with a flattish organic growth and the pricing impact is falling off as well and then the inventory channel clearing as you can see from the chart that we posted out there.

Paul Chung^ Got it.

John Heyman^ And I'd say just to add on to that, on the second part of your question, I'd say, I think you were at CEDIA and you saw a lot of the new products that were going to be introduced into the channel later in the fourth quarter and early in the first quarter, and now you've seen those products launched. And so [inside] surveillance, the combination of the Luma x20 cameras and the software foundation behind that, our new Wi-Fi 6 access points with Araknis, we are now getting into the outdoor season.

So kind of the Radiance product. The combination of our New CORE Controllers launched last year and the Halo Family of Remotes this year. Lighting is a big initiative inside our industry. And so Vibrant Lighting and integrators know what's coming in terms of the future around that. I'd say those products that are connected to one or both of our software platforms, OvrC or our Control4 OS3, that is where we're seeing the most momentum. And what I would say there is it's just the beginning. The initial launches of these products will lead to families of products in the future that will be long-lasting.

Paul Chung^ Okay. Great. And then much better free cash flow performance than kind of expected. You talked about the inventory dynamics going on there. And then I think you reiterated the kind of inventory marked as we exit the year. So how do we think about the overall free cash flow guide for the year? And then kind of given the better outlook, raise profitability and cash flow, are you looking to open up more stores this year and get that incremental revenue boost? It looks like you added an additional location in the quarter.

Michael Carlet^ Sure, Paul. So yes, inventory, we're putting a lot of focus on it, and we've started to see the benefit. I think our inventory actually dropped $1 million from the end of the year to the end of the quarter, which was ahead of our expectations on when we will start seeing the benefit of that. Again, a lot of great work by our supply chain teams to get us where we need to be righted. We don't guide to free cash flow. But from an expectation standpoint, if we're at $314 million of inventory in the quarter, and we're going to get down to $275 million, clearly, that's going to be a source of cash as we go through the year and be able to utilize our existing inventory and liquidate some of that and monetize it. So we feel really good about that as we go through.

Yes. And then on the local store openings, we've got a plan for mid-single digits opening, something between 4 and 6 for the rest of the year. I think we've got a Raleigh store slated to open here in the next few weeks and then a couple more leases. Opening a store is not a fast activity. You got to find the location, you got to sign the lease, you got to do the build-out. So I think we have a pretty good line of sight for what's going to happen the rest of this year. And so we will certainly be thinking about how we deploy capital as we go forward next year as we free up more free cash flow to go do that.

And we have some -- there's some M&A opportunities out there, small stuff that we're looking at. We could deploy into new store openings. We can look at some investments in products that we're contemplating. So lots -- there's no lack of opportunities for us to invest in the business that we would consider.

Paul Chung^ Okay. Great. Very nice execution.

Michael Carlet^ Thanks, Paul.

Operator^ One moment for your next question. Your next question comes from the line of Chris Snyder with UBS.

Christopher Snyder^ I was hoping to get an update or just some more color on activity at the integrator level. Is the customer base being the integrators? Are they still working with big backlogs? Have they worked in -- eaten into those backlogs at all? So just kind of any update on how the integrator is doing and kind of how their pipeline of activity looks?

John Heyman^ Yes. Thanks, Chris. We watch that and other demand sensors very carefully in the business. I would say we have seen a small trend downward in integrator backlog. It's still, if you look at it on a more normal basis at a over 20 years still at a very high level right at a couple of months' worth of backlog. So that's the first comment I'd make. The second comment I'd make above and beyond that, that speaks to our integrators', again, ability to go find business is, as we survey our integrators, the vast majority are finding new customers and new leads to feed that backlog.

And I would say after a few months of what I'll call a little bit of downturn of their own optimism in the market, that has now taken a turn upward. And I think that's all good news. Again, I just need to emphasize that there's always been way too much work out there for our integrators to get to. And so even though, as we all view the news that there are some reductions in things like housing starts and housing sales, our integrators have plenty of work to get to. And so we view the fact that there may be some pullback in macro demand sensors as things that our integrators can actually work through because they've only had a certain level of capacity.

Christopher Snyder^ Appreciate that, John. Really helpful. Then if I could just follow up on the comment you just made around the integrator. I think maybe their optimism have

started to kind of pick back up here on the leading edge. What do you think is driving that?

John Heyman^ I think the biggest thing that's driving it is there's been a lot of negative news cycles, yet they still see their businesses performing well. Yes, they're cautious certainly. But now that we've gotten into this cycle over the past 3 months to 6 months, they see that, okay, there are plenty of homes still being built. There's commercial business that is continuing to return since the COVID days as people are coming back to work. And so I think as they get further into what was supposed to be a more down cycle, they're seeing their businesses continue to perform and their backlog is holding up quite nicely.

Operator^ One moment for your next question. And your next question comes from the line of Keith Hughes with Truist Securities.

Keith Hughes^ On the inventory reduction that we've been talking about on this call, the remainder of the year, do you expect to take a big hit on that in the second quarter and then it tail off or it will be more ratable for the rest of the year?

Michael Carlet^ I think right now, Keith, it's more ratable the rest of the year. I think it's a dynamic that we are still looking to understand as it's coming out, like we know what happens every single month. Historically, as it went in, we can go back and look. We know what's come out over the last 9 months. But as we try to look out there in the future -- and just I'd assume we talk about inventory in the channel, not our inventory as we talk about that.

Keith Hughes^ Yes, exactly. Yes.

Michael Carlet^ And as we look out in the future, I thought more was going to come out in Q1 based upon the pace that was there. I think if I think about that $65 million, I would expect more to come out in Q2 and Q3 and Q4 as we sit here today. That's my best guess, but it's something that I think is a little bit crystal ball as we try to guess. We still are predicting it all to come out. And again, as I said, I think we're getting at least some communication from some of our partners that maybe it's not all going to come out. They're going to adjust a higher level of inventory. And so maybe the whole $65 million doesn't come out, maybe it's $40 million or $50 million instead of $65 million.

And I think pro ratably through the next 2 quarters with a tail in Q4 is how we think about it. But I think we're pretty confident that wherever we are by the end of the year is going to be the new normal, like I don't think this is going to drag into next year. Whatever happens this year will happen and then I think will be pretty clean starting next year.

Keith Hughes^ Okay. And given the banking situation on smaller banks, there's a huge question on financing for small businesses and small commercial products -- projects. Do your integrators, do they tend to be financed just by the receivables you give them or do

they tend to use at least for working capital or jobs, any sort of small bank type financing?

Michael Carlet^ That's a great question, Keith. I don't want to speak for the entire industry. I would tell you generally, they operate just on cash flow. They're going out to a project. They're getting a deposit on that project from the end consumer, that consumer is typically a very well-off individual or business who is using cash to pay that deposit. They'll use that deposit to buy product, they'll install that product, there'll be some contingency on the back of it. But they typically get progress billings throughout the project. So I have never heard anybody talk significantly about using third-party financing as a portion of business. They do use us. There's a little bit of financing of end projects, but not a lot that's out there. John, do you hear anything differently?

John Heyman^ No, I think -- I want to emphasize, I think they use their customers to finance their business and they're not really dependent on banks for things like lines of credit like more -- and revolvers like businesses, our size might.

Keith Hughes^ Okay. And your competitors are smaller, they probably do use that. Would that be correct?

John Heyman^ I would say, generally speaking, we're -- on the distribution side, there's one very large public distributor we compete with who I don't think is dependent on that, but I think the majority of other small business distributors are. And then most of the product companies we compete with are smaller companies, certainly not the Samsungs, by the way, but we're more a partner with Samsung than a competitor. And I think they probably are more dependent on -- more dependent and probably more susceptible to what's going on with banks.

Operator^ (Operator Instructions) And our next question comes from the line of (Inaudible) with Raymond James.

Unidentified Partner^ Just a couple of quick points for me. So one, could you just touch on sort of the demand trends you're seeing in international? And just any color on what you saw international over the past couple of months would be helpful?

Michael Carlet^ So -- thanks. I think, overall, our international business has been a little bit more challenged than our domestic business. So international, as you know, is not one market. We have distribution centers in Canada. We have them in the U.K. We have them in Australia, and we're direct in all those markets. And then we go through most of the rest of the world through distribution partners to cover the rest.

And I think it definitely is up and down. I think the APAC region right now, interestingly, has been a little bit more challenged over the first quarter. The European market, particularly the U.K. has looked pretty much like the U.S., a little bit softer. Canada has looked almost just like the U.S., in fact, might be even a little bit stronger than the U.S. So that's a little bit regionality as you think about the different markets that are out there.

But overall, international in total, just a little bit softer than the domestic markets that we're looking at.

Operator^ At this time, this concludes our question-and-answer session.

I would now like to turn the call back over to Mr. Heyman for his closing remarks.

John Heyman^ Thank you very much, and thank you again, everyone, for joining us today. Huge shout out to our team members who continue to do great work on behalf of our partners and on the part of our shareholders. And we very much look forward to speaking with everyone again at the end of the second quarter.

Have a great evening.

Operator^ Thank you for joining us today for Snap One's fiscal first quarter 2023 earnings conference call.

You may now disconnect.