Snap One Holdings Corp(Q2 2023 Earnings)

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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
- Ashley Swenson; Snap One Holdings Corp.; SVP of Marketing

Participants:

- Erik Woodring; Morgan Stanley; Analyst
- Jake Norrison; Raymond James; Analyst

PRESENTATION

Operator^ Good afternoon. Welcome to Snap One Holdings Fiscal Second 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^ Great. Thank you. Good afternoon, and welcome to Snap One's fiscal second 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, and our most recent quarterly report on Form 10-Q.

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, August 8, 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 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^ Thank you, Eric, and welcome, everyone, and thanks for joining us this afternoon. To begin today's discussion, I'm going to give some company background, followed by a review of our recent performance, and then I'll turn the call over to Mike Carlet, our CFO. He will discuss our 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 before opening the call for questions.

Let's get started. As a reminder, 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 of these integrators, we work with our growing network of approximately 20,000 do-it-for-me integrators to distribute our proprietary and third-party products through our e-commerce portal and local branches. We further support our integrated partners with our proprietary software platforms and workflow solutions to allow them to successfully serve their customers across the project life cycle.

We believe the smart living opportunity is large and durable. Secular tailwinds, including technology adoption, software enablement, housing construction and small business formation will continue to propel the industry and our company forward. Many end users will seek professional health to select, install, integrate and support the technology solutions they require. At Snap One, we aim to provide our integrator partners with the right products, software, services and workflow tools to capitalize on the smart living opportunity.

I'll turn now to our recent performance. Our team delivered solid Q2 results, including $274.4 million in net sales and $31.7 million in adjusted EBITDA, while ongoing channel inventory destocking impacted top line results, as anticipated, we are executing on our product development, go-to-market and margin enhancement strategies. We drove a sequential quarterly improvement in contribution margin rate from 42.1% of net sales in Q1 to 42.7% of net sales in Q2 as we continue to extract costs from our supply chain.

Additionally, our focus on disciplined cost and investment management is expanding operating margins for the business. We continue to see stability in the demand environment amid the broader macroeconomic uncertainty. First, our partners continue to indicate that they are sustaining healthy backlogs in their own businesses. Our diversified business model and product portfolio allow us to serve integrator partners across a variety of residential and commercial end markets, which supports our partners' ability to pivot projects and adapt to the current environment.

Also, while we're hearing some cautiousness from more budget-oriented end customers for entry-level projects, we believe that the high-end residential and growing commercial markets remain resilient. Second, the macroeconomic backdrop, which has proved volatile in recent quarters, showed some sequential improvement across several indicators, including homebuilder confidence, luxury home market health and overall U.S. consumer confidence. All signs point to a housing market that notwithstanding shorter-term headwinds around interest rates and inventory availability will be quite robust while we look over the next decade.

As we reflect on our second quarter performance and look ahead to the remainder of the year, we are focused on two key strategic initiatives for '23. One, driving higher product adoption by our partners and in turn, delivering far better end customer experiences. And two, expanding our operating margins through several key programs, which have already yielded very positive results.

I'll take a few minutes to address each of these in the context of our second quarter results and the rest of the year outlook. First, partner adoption. Following a period of significant supply chain uncertainty, we believe we are well positioned to drive significant adoption of our products with a multipronged approach that includes both introducing new products and software and refining our go-to-market strategy. Coming off of strong first quarter of product launches, we continue delivering new product innovation and enhanced software platform capabilities in the second quarter, including the introductions of exciting new solutions across audio, control, surveillance and networking.

A few important highlights include. One, the core light controller, which offers our partners a simple and profitable solution for single-room applications. completing what we believe to be the industry's most robust lineup of controllers and makes an entry-level Control4 ecosystem more accessible. Two, the Triad passive soundbars product line, which underscores our continued investments in premium audio solutions for our partners. And three, continued product innovation designed for the commercial market, including multi-gig Araknis routers and award-winning Strong Carbon Series mounts.

Finally, I'd be remiss not to mention our July launch of the flagship Halo Touch. Our latest touchscreen remote that also enables voice interaction with our systems. Together, these exciting launches strengthen our product portfolio and help us set a strong foundation for a robust pipeline of continuous innovation for Snap One. Our partners recognized this innovation by ranking us a top 5 brand 45x across 62 product subcategories in the 2023 CE Pro 100 Brand Analysis awards, which represents 5x the number of recognitions of the next closest competitor. As our product offerings become more software-centric, we continue to invest in both our overseas and Control4 software platforms. These platforms provide for value-added services, which we plan to build upon in the near future.

Also, we continue to make progress on our go-to-market strategy, as we pursue growth opportunities in new markets. First, we completed the conversion of our legacy Snap AV and Control4 domestic e-commerce portals to a single platform in order to enable our partners to engage with us more efficiently, allow us to drive marketing programs with higher efficacy and streamline our internal operations. Second, we continue to leverage our best-in-class loyalty program to drive product category and ecosystem adoption and to further strengthen product adoption by our partners.

And finally, we've continued investing in our strategic omnichannel presence, including the opening of our new Raleigh location in July and several anticipated additional branch openings in the second half of the year. Our second strategic initiative is driving operating margin expansion. During COVID and the supply chain crisis, we made a number of decisions that focused on keeping our partners in business. Fees range from inefficiencies from securing and expediting product and components rate to numerous research and development pivots based on abrupt changes in ship availability.

As the supply chain has normalized, we are returning to our operational cadence of driving lower unit costs and freeing up our product teams to do what they do best, build new products. We're also driving scale within our operating model, integration activity related to previously completed acquisitions, as well as investments we have been making within our technology infrastructure are starting to yield results. These investments will support our operating growth -- operating margin growth expectations throughout the remainder of 2023.

Let me now comment briefly on our outlook before turning the call over to Mike. With the first half of the year now complete, our full year 2023 outlook remains positive, as we seek to move past the channel inventory destocking headwind, drive operating margin expansion and enhance our liquidity position. Also, our continued contribution margin rate expansion and disciplined cost structure management provide us with confidence in our profitability expectations.

Therefore, we are reaffirming our outlook for both net sales and adjusted EBITDA for 2023, which Mike will discuss in further detail. We believe that growth in smart living adoption, the central role of the integrator in providing holistic solutions, our competitive differentiation and our coming service innovations will enable us to prosper in a dynamic macro environment and will propel us -- propel -- excuse me, people our long-term success.

With that, I'll turn it over to Mike, our CFO, to discuss our second quarter financial results and '23 outlook in greater detail. Mike?

Michael Carlet^ Thanks, John. Let's turn now to our financial results for the fiscal second quarter ended June 30, 2023. Net sales in the fiscal second quarter decreased 7.6% to $274.4 million, down from $296.9 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 $35 million of channel inventory sell-in occurred in Q2 of 2022 and approximately $10 million destocked in Q2 of 2023, representing a year-over-year top line headwind of approximately $45 million.

After adjusting for our estimates of the channel inventory destocking impact, we believe we delivered year-over-year net sales growth of approximately 8% in the second quarter. Continuing with the channel inventory topic, our data indicates that integrators have been working through their excess inventory since door levels peaked around mid-2022. And we expect the sell-down to continue at a moderate rate through the second half of this year. As we survey our integrator partners, there is some indication that they may be adapting to a new normal level of higher inventory on hand. We continue to believe that the industry will arrive at this new normal by the end of this year, and we will stabilize going forward.

Contribution margin, a non-GAAP measurement of operating performance increased 0.6% to $117.2 million or 42.7% of net sales in the fiscal second quarter, that's up from $116.5 million or 39.2% 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 continued to ease. Our selling, general and administrative expenses in our fiscal second quarter decreased 1.7% to $93.8 million or 34.2% of net sales from $95.4 million or 32.1% of net sales in comparable year ago period.

Decrease in SG&A expense was primarily attributable to lower variable expenses as a result of the lower sales base in Q2 2023. In addition, we incurred lower equity-based compensation in 2023. Our net loss totaled $0.1 million in the second quarter compared to a net loss of $1.3 million in the comparable year ago period. Adjusted EBITDA, a non-GAAP measurement of operating performance totaled $31.7 million or 11.5% of net sales in the 2023 second quarter compared to $31.7 million or 10.7% of net sales in the comparable year ago period. These changes were primarily attributable to contribution margin growth and reduced SG&A expenses, offset by lower net sales, including the headwinds generated by inventory in the channel destocking.

Adjusted net income, a non-GAAP measurement of operating performance decreased 13.1% to $14.3 million or 5.2% of net sales from $16.5 million or 5.6% of net sales in the comparable year ago period. Free cash flow, a non-GAAP measurement of operating performance totaled $9.7 million in the six months ended June 30, 2023, compared to negative $26 million in the comparable year ago period. The increase in free cash flow was primarily attributable to the working capital benefit associated with the reduction in inventory levels. We believe that we remain on track to reduce inventory to the previously communicated $275 million target by the end of the year. At the end of the fiscal second quarter, we had approximately $100.9 million in total liquidity, including cash and cash equivalents of $33.8 million and undrawn revolver capacity of $67.1 million.

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 the fiscal year 2023. As a reminder, Snap One provides annual guidance for net sales as well as for adjusted EBITDA, as we believe these metrics to be key indicators for the overall performance of our business. Our fiscal 2023 guidance considers our first half 2023 performance, as well as our ongoing expectation that market uncertainty will persist throughout the remainder of the year. With these factors in mind, we are reaffirming our previously communicated full year outlook. We continue to expect net sales in the fiscal year ending December 29, 2023, to range between $1.06 billion and $1.09 billion, which will represent a decrease of 5.7% to 3% compared to the prior fiscal year on an as-reported basis.

We also continue to expect adjusted EBITDA to range between $110 million and $118 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 ongoing focus to drive incremental adjusted EBITDA margin expansion in 2023. We have already made significant strides in this area, and we expect to continue to drive year-over-year improvement in the coming quarters through contribution margin rate improvement as supply chain and input costs normalize, as well as through disciplined operating expense management.

That completes my summary. I'll now turn the call back over to you, John.

John Heyman^ Thank you, Mike. A few closing thoughts before we hit Q&A. First, we are proud of our team's ability to deliver steady EBITDA compared to the same period last year and expand our operating margins, despite the headwinds that we've referred to. And we remain confident in our expectations for consistent long-term growth. Through two quarters, we've made strong gains in our contribution margin as costs related to the supply chain continue to alleviate, and we believe our operating margin expansion plan is on track.

Two, we remain committed to our overarching strategy. This includes growth via new proprietary product launches and market-leading service, growth in new markets such as commercial and security, additional local branch openings and transformational software investments, all with our partners' top of mind. Even in an uncertain operating environment, we continue to strive to be the one partner that our innovators trust to support and grow their businesses.

Third, and as I 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 consumer, more capacity for the integrator and growth for Snap One in a way that increases operating margins over time.

And with that, Grace, please open the call for Q&A.

QUESTIONS AND ANSWERS

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

Erik Woodring^ Nice quarter. Can you, John, maybe just elaborate a bit more on your customer conversations? Just how they've trended in the last 90 days? And the reason I ask is, we've heard from some other, let's call it, integrated -- excuse me, distributors or smart home vendors that residential AV demand was maybe a bit weaker in the quarter.

Clearly, your comments wouldn't suggest so. So just how have customer conversations trended? How are integrators feeling about their business? Maybe just a little double clicking on that original comment would be helpful. And then I have a follow-up for you.

John Heyman^ Yes. Erik, obviously, we speak with our customers quite a bit. Rather than share kind of anecdotal conversations with you, I think what we've learned is to best rely on data and where we get the best data is through our surveys and through other surveys and through visibility into what's happening into proposal work out there. And what I'll first say is, I think there is a slight decline in backlogs. So that is something that's evident. Yes, it's still very healthy. I would characterize the decline in backlogs as low single-digits, in terms of percentages.

And so, then you have to kind of double click when you're talking about residential as to kind of the segments. So clearly, we've seen some weakness in what I'll call the general production builder segment. That's where our security products play more. On the other side of the coin, what we're seeing in kind of our core residential AV market, where as we said and as the backlogs would indicate, their capacity was a limiting factor during our growth. It's also something that I think has protected us from kind of what might be happening in certain end markets. And so, that would be the second factor.

And then the third factor I'll cite is our products. Like we have really amazing products, and they're only getting better this year. And I think as the CE Pro 100 survey would say, as we see another data, we're winning share out there. And so, our products are only available from us, they're not available from any other distributor. And I think that's kept our business strong.

Michael Carlet^ Erik, it's Mike. Let me just put one thing on top of that. As you talk about other folks, I don't want to speak for them, but I'm not sure how they will be considering the channel inventory as they talk about demand being down. And so, I think everybody has to think about the impact of channel inventory on their own demand factors. And we're talking about excluding the inventory impacts our demand, we feel it's up a little bit, but [also] channel inventory is a negative against that.

Erik Woodring^ Okay. No, that's very clear. Very helpful color from both of you guys. My second question maybe for you, Mike is, clearly non-GAAP contribution margin saw a nice tailwind from pricing. I think it was a four point tailwind year-over-year in the quarter. Can you maybe just remind us exactly when you raise prices historically by how much? And then what pricing actions you're taking in the market today, if any? And that's it for me.

Michael Carlet^ Erik, yes over the last couple of years, I would say we've had a number of pricing actions. If you go all the way back to August of '21, we raised price about 6%, we raised price another 6% in February '22, about 9% in June and been very minimal activity since then. So all that is now sort of behind us. In fact, with our last price increase being last June, when we get to Q3 on a year-over-year comparative basis, pricing will not be a factor as we think about the sales comparative.

Operator^ Our next question comes from the line of Jake Norrison with Raymond James.

Jake Norrison^ Just double clicking on the integrators. I'm wondering if you could provide us any color on the mix of integrated ads and how that's been trending? And then more broadly, how has integrated churn metrics been looking as backlog has picked up? When do those typically get more volatile? More color there would be helpful.

Michael Carlet^ Jake, it's Mike. We don't disclose integrated accounts on a quarterly basis. Annually, we'll talk about those numbers once a year, but we don't talk about it on a quarterly basis. I can tell you that underneath it, our integrated accounts is very consistent with historical norms. There is not a lot of fluctuation in it right now. I think our industry is not adding tons and tons of integrators. We're winning more integrators of the business, and we're seeing the normal very low levels of churn. One of the great things about our business is, our integrators tend to be pretty profitable. They tend to stay in business for a long time. And so, very little churn, and we're seeing the same consistent sort of integrated accounts that we have historically.

Jake Norrison^ Okay. Perfect. And then just quickly, looking at the rest of 2023, if you could just provide more color on how you're looking at the mix of proprietary versus third-party playing out, especially with the sort of supply chain tailwinds as you talked about.

Michael Carlet^ Yes. Let me one second to (inaudible). I think as we sit here today, when we talk about the mix of products, our 1P mix over the last couple of quarters has been between 67% to 68%. Generally, that stays pretty consistent. We don't expect to see much movement. Remember, in Q4, we always see the percentage of three key products pick up a little bit. A lot of other consumer products are doing end-of-year discounting and holiday promotions. So we do see it move a little bit.

We continue to look to see on a same-store basis, a slight increase in our 1P mix. However, as we add more local stores, that always dragged it down a little bit. And so, we expect over the next couple of years as we continue to grow our store base to see a small decrease in the 1P mix. But we don't expect it to move dramatically from where it is right now.

Operator^ (Operator Instructions)

Ashley Swenson^ Hi, Grace. If there's no more questions, I think we are fine to end the call.

John Heyman^ Well, let me just quickly thank everyone, Ashley, for joining us today. I want to especially thank our team members for their ongoing contributions as well as our network of incredible integration partners who continue to do great work, creating amazing experiences for individuals and businesses everywhere. And I'd like to also thank our investors for your continued support. We'll talk to you next quarter. Grace?

Operator^ Thank you for joining us today for Snap One's fiscal second quarter 2023 earnings conference call. You may now disconnect.