Snap One Holdings Corp. (Q1 2022 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
- Mike Carlet; Snap One Holdings Corp.; CFO

Participants:

- Erik Woodring; Morgan Stanley; Research Associate
- Paul Chung; JPMorgan Chase & Co; VP & IT Hardware Analyst
- Stephen Volkmann; Jefferies LLC; Equity Analyst
- Chris Snyder; UBS Investment Bank; Analyst
- Ketan Mamtora; BMO Capital Markets Equity Research; Analyst
- Adam Tindle; Raymond James & Associates, Inc.; Senior Research Associate
- Keith Hughes; Truist Securities, Inc.; MD
- Ryan Merkel; William Blair & Company L.L.C.; Research Analyst
- Brian Ruttenbur; Imperial Capital, LLC; Research Analyst

PRESENTATION

Operator: Good afternoon. Welcome to Snap One Holdings Corp. Fiscal First Quarter 2022 Earnings Conference Call. (Operator Instructions) I would now like to turn the call over to Snap One Senior Vice President of Finance, Eric Steele. Sir, please proceed.

Eric Steele: Great. Thank you, operator. Good afternoon, and welcome to Snap One's Fiscal First Quarter 2022 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 annual report on Form 10-K for the annual period ended December 31, 2021 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 12, 2022.

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.snapne.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.

With that, I'll now turn the call over to our CEO, John Heyman. John?

John Heyman: Eric, thank you. Welcome, everyone, and again, thanks for joining us this afternoon. To start today's discussion, I will review recent highlights and updates, and then I'll turn the call over to our CFO, Mike Carlet, who will discuss our financial results for the quarter, as well as provide an update on our outlook for the remainder of 2022. After that, I'll share some closing remarks, and then we'll open the call up for questions.

As a brief reminder to everyone listening here at Snap One, we provide a smart living platform that empowers professional integrators to deliver joy, connectivity and security to end consumers on a global scale. As a leading distributor to this industry, 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 further support our integration partners with our proprietary software platforms and digital workflow solutions to allow them to successfully serve their residential and commercial customers across the project life cycle.

The smart living opportunity is large and mostly untapped. With our entrenched and growing integrator network, we believe we're strategically positioned to power the smart living revolution. As demand for smart living solutions continues to rise, we anticipate an increasing number of end consumers will rely on professionals to get the job done. In turn, we're positioning our integrators and our company to capitalize on the tremendous and durable growth opportunity in front of us.

It's within this robust secular demand environment for smart living experiences that we see our business continuing to propel forward. Clearly, there is uncertainty that exists in the market, including inflation, the war in Ukraine, supply chain constraints and rising interest rates. However, we believe we are still operating in a favorable macro and micro backdrop.

Despite the economic uncertainty, our integrator partners remain busy and demand remains strong. Macro indicators such as housing starts, building permits, housing completions and residential construction backlogs, even if down modestly on a sequential basis, are robust and positioned favorably relative to historical averages.

Additionally, repair and remodel spend is expected to expand, and the backdrop for housing at the higher end of the market remains more insulated than the broader market. Specifically, the demand for luxury single-family homes remains strong, inventory remains below traditional levels, and that provides a sustainable runway of home buyers seeking luxury properties in which our solutions are frequently installed.

The secular trends surrounding population movements, housing shortages and the proliferation of smart living gives us confidence in a favorable long-term growth outlook. Furthermore, commercial business continues to rebound post-COVID, and our integrators have shown the ability over time to successfully pivot their project types in different market environments.

With this backdrop, we aim to help these integrators enhance their capacity and to grow profitable businesses. We do this through investing in our business platform, which provides needed infrastructure and otherwise makes life easy for the small businesses we serve.

Further, we complement this business platform with a product platform that supports easier installations, higher profits, improved reliability and enhanced end consumer satisfaction. We believe that no one is investing in these types of platforms that will drive the future success of this industry like Snap One.

Let me now take a minute and reflect on the past quarter. These are indeed unprecedented times. But our unwavering commitment to our integration partners has remained stalwart. Our objective everyday is to ensure that our integrator partners have the products they need to be successful as they meet the continued robust demand for smart living solutions.

Coming off a banner 2021, we continue to capitalize on the growth opportunities in front of us this past quarter. Beginning with the top line, we generated over $277 million in net sales during the quarter, an increase of 28 -- excuse me, 25.8% from the comparable year ago period. Our efforts to meet demand have resulted in additional cost to the business, primarily from inflationary pressures and supply chain constraints. However, our skilled execution allowed us to deliver adjusted EBITDA of $23.6 million, an increase of just over 1% from the prior year on an as-reported basis. This included approximately $2 million in public company-related expenses that we did not incur in the prior year. Excluding those expenses, adjusted EBITDA increased 10% year-over-year.

We also successfully executed across a range of strategic initiatives, including the following key accomplishments: First, in January, we announced the acquisition of Staub Electronics. As a long-time distribution partner in Canada, the acquisition was a natural way for us to deliver more product choice, faster fulfillment and superior support for professional integrators across Canada. This strategic acquisition accelerates our penetration of the Canadian market, and it positions us for long-term growth in this important geography.

Second, effective January 31, we launched our all-new Partner Rewards Program, which unifies the previous Snap One, Control4 and local distribution loyalty programs under a single program. We believe the industry's most rewarding program just got even better as Snap One integrators now earn rewards on every purchase. Additionally, the unified points-based program is a critical step forward in enabling us to deploy digitally-enabled strategies to expose our integrators to new products and drive wallet share growth.

Third, we were humbled to earn 17 awards across 22 categories and the CE Pro 2022 Quest for Quality Awards announced in March. Snap One 17 honors were more than twice as many as the next most awarded competitor and reflect the outstanding service we deliver. Thank you to our partners for your vote of confidence in Snap One and to our team members for your exceptional service.

Fourth, we continue to build our omnichannel presence with the opening of a new local branch to serve the Washington, D.C. Metro area, bringing our domestic footprint to 31 local branches. Our local branches strengthen our existing integration relationships, they add incremental purchase opportunities and expand our integrator network in the local community. We intend to continue investing in the expansion of our local branch network.

Fifth, we bolstered our senior leadership team through the appointment of our new Chief Information Officer, Maneet Singh. Maneet will focus on the strategic design and implementation of business infrastructure to enable scalable and efficient growth. We're thrilled to welcome Maneet to our team.

Our success in Q1 continues to reflect the strong execution against our proven playbook to drive sustainable long-term growth. As a reminder, this growth strategy remains rooted in 5 key pillars: #1, increase our wallet share with existing integrators; two, expand our global integrator network; three, innovate with new products, software and tech-enabled workflow solutions; four, develop new software services and revenue models; and five, execute on strategic M&A. We continue to make progress on all these fronts as we look to '23 and beyond.

Let me now comment briefly on our outlook for the rest of the year, and then I'll turn the call over to Mike. As I spoke to earlier, while supply chain challenges persist, we have strategically deployed our balance sheet and executed well to circumvent these near-term hurdles. Our team has been hard at work optimizing our approaches to componentry sourcing, inbound logistics and air freight.

Our engineering teams have worked tirelessly to reengineer products based on component availability. Our sales and support teams work diligently to find available products to quickly and efficiently meet our integrators project needs. Thanks to their efforts and sustained demand from our integrators, we've continued to drive strong performance, positioning us firmly to meet our objectives for the year.

Notwithstanding the efforts of these teams, these challenges come with added costs as have been well publicized in the general economy. Fortunately, we've utilized an evolving pricing strategy in a balanced manner as we assess rising costs, competitive forces and the affordability of solutions the industry offers.

Earlier this week, we announced a price adjustment on our proprietary product portfolio to address rising supply chain and inflationary cost pressures and to support our investments to further strengthen our leading supply chain capabilities. The approximate 8% blended price adjustment has an effective date of June 6 and is in line with recent competitive moves. We implemented this price adjustment in a way that protects our partners, including by providing advanced notice and by making corresponding adjustments to MSRP.

Most importantly, demand for our products and services remains high, and we've entered 2022 with strong momentum due to continued healthy trends in smart living adoption, in durable residential and commercial uptake, our integrators remain extremely busy with many booked out months in advance. We remain confident in the resiliency of our integrators and our own business and we look forward to expanding our share of a rapidly growing market, while remaining prudently conservative with our expectations.

With that, I will turn the call over to Mike Carlet, our CFO, to discuss our first quarter results and updated 2022 outlook in greater detail. Mike?

Mike Carlet: Thanks, John. So now we'll turn to our financial results for the fiscal first quarter, which ended on April 1, 2022. Net sales in the fiscal first quarter increased 25.8% to $277.4 million, up from $220.5 million in the comparable year ago period. The growth in net sales during the quarter was driven by strong overall demand across geographies, markets and product categories.

Growth was also driven by the benefit of the acquisition of Access Networks, which was acquired in Q2 last year; the partial quarter benefit of Staub Electronics, which, as John said, was acquired in late January this year; and the continued ramp-up of local branches that were opened in the previous year.

Additionally, we benefited from the cumulative impact of price increases taken in the past year, including actions in March and August of 2021, and most recently, in February of 2022. While supply chain challenges represented a low single-digit headwind in the quarter, we continue to take proactive measures to mitigate and deliver for our integrators.

Contribution margin, which is a non-GAAP measurement of operating performance, increased 14.7% to $105.1 million or 37.9% of sales in the fiscal first quarter, which is up from $91.6 million or 41.5% of net sales in the comparable year ago period. The increase in contribution margin dollars was primarily due to net sales growth. The decrease in the contribution margin as a percentage of net sales was primarily related to our local branch expansion and growth strategy, which drove a change in product mix as our local branch

footprint skews towards third-party product sales. As a reminder, third-party products typically had a lower contribution margin as a percentage of net sales relative to our proprietary products.

The strategic expansion of our local branch footprint and 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 integrated loyalty and capturing incremental contribution margin dollars.

Contribution margin as a percentage of net sales also declined relative to the comparable year ago period due to increased componentry and logistics costs related to the broader industry-wide supply chain challenges. These contribution margin rate pressures were partially offset by the pricing actions that have been enacted over the course of the last year.

Our selling, general and administrative expense in fiscal first quarter 2022 increased 14.8% to $86.5 million, which is 31.2% of net sales, which was up from $75.4 million or 34.2% of net sales in the comparable year ago period. The increase in SG&A expenses during the quarter was primarily due to increased costs associated with becoming and operating as a public company, as well as ongoing investments to support strategic growth initiatives, the acquired cost of Access Networks and Staub, which we did not own in the prior year fiscal first quarter. And finally, the recognition of equity-based compensation expenses.

Over the long term, we expect to achieve operating expense leverage as the business scales and we realize the efficiencies of a unified operating platform.

Our net loss totaled $2.3 million in the first quarter compared to a net loss of $6 million in the comparable year ago period. Adjusted EBITDA, which is a non-GAAP measurement of operating performance, increased 1.1% to $23.6 million or 8.5% of net sales in the first quarter of 2022 compared to $23.3 million or 10.6% of net sales in the comparable year ago period.

After normalizing adjusted EBITDA for the approximately $2 million of public company-related expenses that we incurred in the quarter, comparable year-over-year growth in adjusted EBITDA was 10.1%. The adjusted EBITDA growth in the quarter was primarily attributable to net sales and contribution margin growth, offset by the increased SG&A expenses. The decrease in adjusted EBITDA as a percentage of net sales in the quarter is primarily attributable to the contribution margin as a percentage of net sales declining on a year-over-year basis.

Adjusted net income, a non-GAAP measurement of operating performance, increased 18.6% to $10.7 million or 3.9% of net sales, up from $9 million or 4.1% of net sales in the comparable year-ago period.

Free cash flow, a non-GAAP measurement of operating performance, totaled negative $26.3 million in the 3 months ended April 1, 2022, compared to negative $25.9 million in the comparable year ago period. The decrease in free cash flow was primarily attributable to net cash used in operating activities and an increase in purchases of property and equipment compared to the comparable year ago period.

Net cash used in operating activities was driven by the strategic use of our balance sheet to protect against supply chain uncertainty, resulting in the use of net working capital, including increases in inventory. At the end of the fiscal first quarter of 2022, cash and cash equivalents were $25.1 million.

In addition to the financial metrics we've reported to date, I would like to take this time to formally introduce additional revenue disaggregation disclosures and a few key performance indicators or KPIs. Our goal with these metrics is to provide investors with enhanced visibility into our performance.

Previously, we disaggregated revenue by geography between the United States, or domestic, and international. We are now further expanding our domestic revenue disaggregation to distinguish between domestic integrated revenue and domestic other revenue. Domestic integrated revenue represents the majority of our business today and is transacted on a direct to integrator basis. While domestic other revenue reflects recently acquired entities and revenue generated through managed transactions with nonintegrated customers, such as National Accounts.

We are also introducing a new revenue disaggregation to categorize our sales by product type between proprietary and third-party products. Our proprietary product is one where Snap One has developed the products and services internally, and is distributed under one of Snap One's proprietary brands. A proprietary product typically generates a higher contribution margin rate to Snap One relative to a third-party product. All of the revenue disaggregation disclosures will be reported on a quarterly basis going forward.

So in Q1 2022, proprietary product represented 67.7% of net sales, down from 69% in Q1 of 2021. The decrease in proprietary sales mix is driven by the growth of third-party products outpacing the growth of proprietary product, primarily related to our strategic efforts to expand our local branch network where we typically sell more third-party product than proprietary product.

In addition, to provide enhanced visibility into key operating metrics, we are introducing new KPIs regarding the count of transacting domestic integrators and the spend for transacting domestic integrator. These metrics will be presented annually on a fiscal year-end basis.

In fiscal year 2021, we transacted with approximately 20,000 domestic integrators who spend $41,500 on average. On a year-over-year basis, the number of transaction domestic integrators and spend per transacting integrator increased 11.7% and 8.4%, respectively.

Over time, we have demonstrated a consistent ability to grow both our number of domestic integrators, as well as our spend per domestic integrator.

Now before I turn the call back over to John, I'll take just a few minutes to provide an update on our financial outlook for the remainder of the year. As a reminder, Snap One provides 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.

Our fiscal 2022 revised guidance considers our fiscal first quarter outperformance, our recently announced price adjustment, which is effective June 6, and our anticipation of continued supply chain headwinds and economic uncertainty. Taking these factors into consideration, we expect net sales in the fiscal year ending December 30, 2022 to range between $1.16 billion and $1.18 billion, which would represent an increase of 15% to 17% compared to the prior fiscal year on an as-reported basis, and an increase of 17% to 19% after adjusting fiscal '21 to remove the impact of the 53rd week.

The upwardly revised guidance represents an increase of $20 million and $10 million to the low and high end, respectively, of our initial guidance range that we communicated in March in conjunction with our fiscal 2021 earnings.

We believe the contributing factors to our 2022 net sales growth on a 52-week basis are as follows: 12% to 14% of our growth will come from organic growth, which includes volume, historical and planned pricing actions, as well as the impact of new local branch openings. 5% of the growth will come from the impact of recently completed M&A, including Access Networks and Staub Electronics. On an as-reported basis, the lapping of the 53rd week in 2021 represents approximately 2% net sales growth headwind.

We expect adjusted EBITDA to range between $116 million and $121 million, representing an increase of 5% to 9% compared to the prior fiscal year on an as-reported basis. Presenting 2021 on a 52-week adjusted basis and annualizing for a full year of public company costs of approximately $8.4 million our 2022 adjusted EBITDA guidance would represent a year-over-year increase of 10% to 15%. This upwardly revised guidance represents an increase of $2 million and $1 million to the low and high end, respectively, of our initial guidance range, which we communicated in March in conjunction with our fiscal 2021 earnings.

Overall, we remain highly confident in the financial health of our business, as well as our ability to sustainably grow for the foreseeable future.

And one final update before I pass the call over to John. As stated in today's earnings press release, we announced that the Snap One Board of Directors has approved a stock repurchase program that authorizes the potential repurchase of up to $25 million of our common stock through the end of 2023. We believe our entrenched relationships and the reoccurring spending patterns of our integrators yields an attractive cash flow-generating business model. These dynamics enable us to continue to prioritize reinvestment in the

growth of our business, as well as the other areas previously noted as the main drivers of our capital allocation strategy.

It is our view that providing our leadership with the additional optionality to maximize returns for shareholders through both our existing operations as well as in the capital markets is the best practice. To the extent we feel that our company's shares present a compelling investment opportunity at their current valuation, we may repurchase our common stock in the open market from time-to-time in amounts, at prices and at such times as the company deems appropriate, subject to market conditions, as well as federal and state laws governing such transactions. We expect to fund the repurchases from our existing cash balance, including cash generated from operations.

That completes my summary. I'd now like to turn the call back over to John for additional comments. John?

John Heyman: Thanks, Mike. A few closing thoughts, and then we'll take Q&A. #1, with the strong sustained industry-wide demand we see, we're continuing to focus on supporting our integrators to capitalize on the opportunity in front of us and them, and that includes new product launches, software investments and platform developments. That's our growth strategy, and it remains our North Star.

Two, our teams continue to work diligently through supply chain and through logistics challenges, and we feel we have the processes in place to handle whatever obstacles might be on the horizon. Priority one remains delivering for our integration partners and ensuring they can keep their projects moving, while priority 1a continues to be doing that in a manner that protects our partners and our company's financial performance using price, MSRP and key productivity levers. As we implement an additional price adjustment in Q2 of this year, we do so with the ability to deliver on those priorities in mind and with the belief that broader challenges will subside over time.

Three, we're proud of our results to date as a public company. We believe we are establishing a track record of consistently delivering on our financial commitments and will continue to focus on driving shareholder value over the short and long term.

And finally, we remain bullish around our long-term operating model, notwithstanding the noise of the current macro environment. The scale and the platforms we're investing in will drive better solutions for the end consumer, more capacity for the integrator and growth for Snap One in a way that increases operating margin over time. Our actions in Q1 have set us up for what we expect to be a year of healthy growth for Snap One, and exciting times are ahead for our amazing team, our integrators and end consumers.

With that, we'll open the call up for Q&A.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) Our first question comes from Erik Woodring with Morgan Stanley.

Erik Woodring: Congrats on a very strong quarter. You guys mentioned the 17 awards you won in the CE Pro Quest for Quality Awards. Can you guys just give us some additional detail, maybe some of the categories where you won, maybe some of the categories that you didn't win? Just help us better understand where you're getting recognized, obviously, 2x unis competitor. But would just love to see better understand where you're actually winning in those categories. And then I have a follow-up.

John Heyman: I'd say there's 2 sets of big awards that the industry offers. One are more product-oriented, and one are more service-oriented. The ones that are more product-oriented good to manufacturers of products, the ones that are more service-oriented go to distributors. So the Quest for Quality Awards are traditionally awarded to distributors. There are some manufacturer elements in there, but traditionally distributors.

Where we are revered are areas like tech support. Our Net Promoter Score continues to be over 90. I think our team is the finest technical support organization in the world. When it ticks on a ladder and they need support and they call us, we answered the phone and solve their problem the vast majority of the time. I would say our supply chain response has been revered this past year. I'd say that manifests itself primarily an in-stock availability.

So those are a couple of big areas. But there's other areas as well with things like our rewards program, best-in-class; our website, best-in-class; brick-and-mortar distribution, best-in-class; our warranty programs, best-in-class. So these are things that are really important to the integrator and allow them to stand behind the service they provide to the end customer.

Areas we didn't win, I actually don't have at the tip of my tongue. Mike, do you have anything to add on that?

Mike Carlet: I think a couple around like social media presence, maybe around lead generation for the integrators, which we -- is an area of focus for us that we talk about doing in the future. But I think the ones where we don't win are areas that just haven't been focused for us.

Erik Woodring: Okay. That's perfect. I love that color. And then maybe just as a follow-up. I love that you guys have a belief in the story. You're obviously starting a buyback program. On the other end, you ended the quarter with $25 million of cash and equivalents. So just help us understand how we should think about Snap One balancing, perhaps the desire to buy back stock at attractive levels with the need to utilize cash flow to invest in the business, all while obviously trying to bring your leverage ratio down to kind of the 3x target you've communicated in the past.

Eric Steele: Yes. Erik, this is Eric from the Snap One team. I think as we think about the repurchase program, I think, #1, we have tremendous confidence in the cash flow generation profile of the business and believe we'll continue to generate sufficient cash flow to execute on the program. I think we also have sized it appropriately as we think about kind of execution capabilities here over the balance of '22 and into '23.

I'd also remind everyone that our capital allocation priority is really, first and foremost, are continuing to invest in our organic growth of the business, followed by accretive M&A as well, which remains an important part of our story. And then we'll continue to look for opportunities to execute opportunistic share repurchases kind of as our #3 priority.

And so we think, overall, as stewards of capital, it's prudent to have a share repurchase program in place, but we'll use that judiciously as we look at trading volumes of the stock and stock price levels.

Erik Woodring: Super. I appreciate the color.

John Heyman: Yes. I think especially when the stock is at somewhat ridiculously low levels.

Erik Woodring: Totally understand.

Operator: Our next question comes from Paul Chung with JPMorgan.

Paul Chung: Nice to see the KPI disclosure coming back here on integrator spend and integrator count. How do we think about kind of the relative strength between those 2 metrics for kind of '22 outlook? I assume with the price increases, maybe the spend is a bit stronger. But if you could also comment on kind of the local branch opening plan for the second half. It looks like the branch openings obviously drive a nice uptick in contribution. So comments on both those would be great. And then I have a follow-up.

Mike Carlet: Sure, Paul. So if we think about last year for the numbers that we reported out, and we think about domestic integrator sales growing about 21%. That growth really was split, not quite evenly between the growth in both, but domestic integrators grew 11.7%. So in 2020, we had 17,900 domestic integrators, which was right around 20,000 in 2021. That's a rounded number, but it was within 30,000 or 40,000 or 20,000 in 2021. So we saw 11.7% growth, and in our spend per integrator grew 8.4% last year, obviously, a component of that being pricing.

As we look at this year, with the price actions we took last year and the price actions we're taking this year, we would expect to spend for it to be a bit more. We're not disaggregating that in our guidance, and we're not getting to the specific quote numbers. But we think in our long-term growth algorithm, both of those levers are really important. Obviously, in this year with the activity around pricing and the inflationary pressure, we're all feeling that, that's going to have some impacts on it. But over the long term, we

expect both of those metrics to grow both the big contributors around 50-50 of how we think about the growth of the business.

As far as the store opening plan, we continue on our path of opening around 10 stores this year. There will be a couple at the end of the year. There's a couple of real estate things. So it might be 9, it might be 11 when we get to the end of the year and see how many we actually get opened, but somewhere around 10 is our goal for the year, and we think we'll be pretty close to that. A little bit less than 1 a month as we look at the openings. And yes, they do clearly drive in those markets, both integrator acquisition and the ability for spend because it creates more buying opportunities for the integrators in those markets.

Paul Chung: Great. And then my follow-up on the pricing adjustments. Since you're kind of telegraphing some increases here for early June, are you seeing kind of a pickup here in 2Q to kind of get ahead of some of those increases? I assume the loss in the channel is quite high as well.

John Heyman: Yes. We just announced the increase on Monday of this week. So we typically won't see the impact of what you would think of as some pull ahead until we get closer to the effective date of that price increase, which is June 6. Some integrators will take advantage of that and use it to stock. But what I'll remind everyone on the call is the vast majority of our integrators actually don't have warehouses. So it's hard for them to do anything but a fairly small amount of buying ahead of that.

And so we'll expect that to happen in early June. We probably won't get much of the benefit of the price increase at all this quarter. And we'll look to start to see that in the second half of the year.

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

Stephen Volkmann: Always good to see more things kind of broken out here but then you get questions on them. So I'm curious if you -- as you show us the spend per -- sorry, the spend per integrator up 8.4%, I may be comparing apples and oranges, but it looks like that was probably almost all priced based on the pricing data that you gave. So I'm curious, did the spend per integrator kind of go up on a unit volume basis?

Mike Carlet: Yes. I think, Paul -- Steve, I'm sorry. As you look at last year, remember the supply chain challenges that came in the back half of the year. So you're right that last year, I think of that 8.4% spend per like 3 quarters that will be attributable to the pricing increase we did. But you also have to think about the impact on volume of the supply chain challenges, which we quoted last year as being in the mid-single digit impact on our top line, which would all -- with almost 100% of that volume piece of it. So absolutely spot on with that observation, but very much driven by the supply chain challenges that we have.

Stephen Volkmann: Okay. All right. And actually, that was kind of my next question was around the supply chain issues. It looks like some of the West Coast port situation is

improving a little bit. Are you seeing some relief on the supply chain side? And do we think that's kind of going to get better over the next 2 or 3 quarters?

Mike Carlet: Yes. So I think when you -- when we talk about supply chain challenges, it really falls into 2 buckets. One is the logistics challenges of the West port -- the West Coast ports, clearing out there, the port delays, potential strikes on the cost that we think won't happen, but we keep an eye on. And then the other side of supply chain challenges is componentry and manufacturing, availability and capacity that's out there.

What we have seen is a shift last year, most of our challenges across the supply chain were logistics based. You're absolutely right. Most of that is cleared at this point. We don't think we're seeing much at all in the way of supply chain challenges from a logistics standpoint. What we are seeing is a couple of dozen SKUs that are impacted by chip shortages, componentry shortages, manufacturing capacity shortage. It's not a -- it doesn't impact a lot of the work. We have over 2,400 proprietary SKUs, and this is affecting dozens. But there are some SKUs that are pretty important and pretty significant volumes.

So we're managing that closely. We're making sure that we're staying on top of that. That's where we think those challenges will continue through this year. We don't think they're going to get worse. It's a little bit like whack-a-mole. You take care of 1, you figure out how to engineer around a chip that we don't have, and then you hear about another chip that impacts 3 other products that you have to think about, how to engineer around or find a replacement for. So our engineering teams, our supply chain team is paying very close attention to it. We think it's going to continue to be a low single-digit headwind through this year.

We think as we hit the end of this year, we expect it to get better. But obviously, there's a lot of uncertainty out there as we look forward. If last year was a mid-single-digit impact, this year we view it as a low single-digit impact, and we think that will continue for most of the year. But not on the logistics side, very much on the sourcing side.

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

Chris Snyder: And appreciate all the detail in the slides, like everybody else. So obviously, a lot of concern in the market around the macro. Can you just provide some color about how the business has performed in prior market downturns or periods of declining or pressure in residential new construction?

John Heyman: Sure. We now have the benefit of going through the 2007, '08, '09 cycle, the current cycle and everything in between. And obviously, there have been really good times during those 15 years and some tougher times. Our business, and I would say, Control4's business before the acquisition, has grown through every cycle. There might have been a short interruption with Control4 that I frankly attribute to product transition, not to the economy.

And I think the reason for that, Chris, is the '07, '08, '09 crisis was so severe that it drove integrators to pivot their capabilities to not just residential but commercial projects. And as a reminder, roughly 1/3 of our business even through our residential integrators goes into commercial establishments. And so generally speaking, when new construction is going really well, that's easy money.

A home or an apartment building is being built, technology has to go in it before the homeowner moves in. And when the money isn't so easy, the integrators have a very large installed base. They have a network of homeowners that they've done installs that have businesses that they'll work for, whether it's the lawyers conference room, the dental office, the restaurant and bar, and they've shown themselves quite adept at pivoting their capacity.

Our commercial business, which was really in tough shape during the COVID years is outpacing the growth of the rest of our business right now. And so to the extent in certain geographies you might see resi slowing down, you -- our integrators show themselves adept at going into commercial enterprises.

So we feel really good about that. We have, over time, continued to refine our product portfolio to have more commercial-oriented products that's both on the proprietary side, as well as the third-party partner side. And so that's why we feel really good even in kind of the current concern around the housing market.

Our integrators -- just 1 last comment. Our integrators are incredibly busy right now. We surveyed them all the time. We subscribe to surveys that third-party companies do, there has been no decline in their outlook or the amount of time they're booked out.

And so I'll pin a counterargument real quick, which is in this economy, if labor softens up, it might be easier for them to expand their capacity because they're booked out. They're booked out months in advance.

Chris Snyder: I appreciate all that color. Really helpful. And then I guess for my follow-up on the guidance, if I just look at the back half, 8% price increase on the portfolio products, back to envelope masses maybe a 3% tailwind for the full year sales. And we expect some flow through there and EBITDA. When I look at the guidance raise, it's less -- is that less than 1% at the midpoint for both sales and EBITDA after a pretty strong Q1? I mean, it doesn't seem like the company's view that supply chains are getting worse. So I guess my question is, is there an offset here? Is it price realization? Is there something I'm missing? Any color here on the moving parts would be helpful.

Mike Carlet: Sure. And so it's not price realization. We expect to get the price, but our costs continue to rise. And so what we're raising our offset is not just the costs that we've already incurred that are reflected in the numbers, but also continued costs that we are looking forward. We're hearing from our suppliers that were going to be impacted going forward, and so the price adjustment that we're putting in today not only covers the

degradation in margin -- contribution margin that we saw in Q1, but also is, therefore, anticipated additional price or cost increases that we know are coming down the pike.

So we're trying to be appropriately conservative in our guidance as we look out there. We're trying to think about the uncertainty that's in the market. We're trying to be prudent with the numbers we're putting out there for everyone. We feel really confident with our numbers. But that price increase that we're putting in there is going to be offset by the continued cost pressures that are out there.

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

Ketan Mamtora: Just on that point, to clarify, the 8% price increase, does it cover the dollar cost and the rate of margin or just the dollar cost?

Mike Carlet: We've done it in a way that should protect our contribution margin and our operating margin. So we're anticipating the costs that are out there. We're trying to protect our integrators margin with our MSRP and trying to protect our margins so that we all can continue to invest in this industry. And so it should protect our margin rate. Again, it's an uncertain world we're all in. So I'm not going to promise you it's going to be spot on. But at least based upon what we know today and what we can anticipate happening, we should be able to protect that margin rate.

I'll be honest, we thought when we did the one in February, we'll do the same thing. We announced that price increase in December, we basically worked on it in October and we realized quickly it didn't cover it as the world has continued to evolve and costs have continued to change and the world continues to evolve. So we'll pay a lot of attention to it, and we'll keep adjusting as needed going forward and making sure our integrators can pass that along to their customers as well.

John Heyman: I think 1 of the things we learned in the -- at the end of the -- as we did the last pricing increase at the end of last year for kind of effective date February 1, was we thought the supply chain was going to turn around towards the middle of this year as most of the economy did. We did not add a buffer of any kind of magnitude, and we've paid the price in the first half of the year a little bit on the cost side.

I think as we look at this current price increase that we've just announced, we have added a buffer. And part of the reason for that is our integrators understand what's happening out there. But it's hard for them to continue to absorb a high frequency of price increases. They have to go update their catalogs.

They have to go out and revise the proposals they have. And so the feedback from them has been less around any kind of price increase itself and just more about don't keep coming back to us, if possible. So the magnitude of this price increase considers a buffer so that we won't have to keep coming back to our integrators. Obviously, if costs continue to rise, we'll have to reconsider that.

Ketan Mamtora: Got you. Okay. No, that's helpful context. And just as my follow-up, can you talk a little bit on what you are doing to kind of diversify the supply base so as to kind of mitigate kind of future sort of challenges on the supply chain side?

John Heyman: Mike?

Mike Carlet: Sure. And so I think back a number of years, we had a lot of our spend coming out of China. I would say, in our proprietary products, it's still very Asia-based with over 95% of our supply chain, of our proprietary products coming out of Asia, but we really have diversified away from that China reliance. So our spend in China is now down to 1/3 of our proprietary products. About 20% of the spend is in Taiwan.

And then we flex to a lot of surrounding areas, Vietnam and Malaysia to diversify away from -- reliance on 1 country. It is very reliant on Asia. We have diversified the ports we're coming out of as well. So we're not totally dependent upon Shanghai or other shutdown areas. Only 1% of our containers have been impacted by the Shanghai shutdown, which has been great. We flexed some shipments to our surrounding ports. We're using other modes of transportation, barges and air, which clearly is one of the costs that we're seeing in our margins as those alternative transportation sources that we're utilizing.

So listen, for the products we make, Asia is still the place to go manufacture them. We look at alternatives. We've evaluated Mexico. We brought some things back there domestically. But I think for the near to midterm, we're still looking for that area of the world as the primary area that we source product from. But we continue to diversify away from relapse in any country within that region.

Operator: Our next question comes from Adam Tindle with Raymond James.

Adam Tindle: John, I just wanted to start on the partner rewards program that you implemented at the end of June. I think of that as sort of the bucket of wallet share opportunity to consolidate more on the Snap One, I would imagine. Just wondering if you maybe speak to early observations of the first few months and activity you're seeing there. And you alluded to some opportunities moving forward, some digital initiatives that sounded interesting. I wondered if you could expand on that as well.

John Heyman: Yes. I think the -- there were 2 components of the rewards design. Component #1 was the design of the program itself. and how we were awarded purchases based on a variety of characteristics of the products and the partner. And we spent a couple of years redesigning that.

The second part of it was actually unifying our view of a business partner, because Control4 did business with 5,000 partners. Snap did business with well over 10,000. And then our local entities, and there were 4 different companies that made up our local entities, they may have done business with that exact same partner. And so we had a lot of crossover. So we had to unify the view of that partner and what they were buying, et

cetera. So at the end of last year and early this year, we were able to bring the new rewards program together and the unified view of the partner.

And in traditional Snap fashion, remembering that this market is highly fragmented with a lot of small businesses, and you can only reach a small portion of the market with conventional sales personnel, we have relied on our website historically to understand purchase behavior by partners and expose them to new products. We have products that we're introducing and get them to try it. So it is inefficient to do that with a traditional feet on the street model.

And so now that we've brought that together, we can start to target individual partner behavior and introduce products and run some of the conventional plays that we've run in the past. There is 1 missing piece to this, though, Adam, which is the actual convergence of the website. First and foremost, the Control4 and the SnapAV website, and that will start later this year. And so as we bring those things together, that will be very important in terms of driving kind of wallet share opportunities.

There's a second component of that in terms of how we've created the engine, the rewards engine itself. And I don't want to talk to that too much because this is a public call, but I think that we can drive even stronger incentives for our integrators to adopt our products. So really excited about all of those things starting to come to life. In the early days, we are seeing results as expected. And one thing I want to point out is we're seeing costs as expected.

And so when you launch a big new loyalty program, one of the things you're concerned about is not just the revenues you're going to drive, but also the costs that go against those revenues. And so our team did a great job modeling all of that. And I think we're going to be able to continue to align our partners around higher share of wallet, better economics for them at a cost level that we -- that meets our expectations.

Adam Tindle: Got it. Makes sense. Looking forward to that. Mike, maybe just as a follow-up on cash flow and capital structure. I think you had a use this quarter just over $20 million and understandably investing to help the supply chain situation. But you've got about $25 million on the balance sheet, about a little over $400 million of net debt. Just wondering how we can think about cash flow going forward or how investors can think about cash flow. I presume based on John's commentary around ridiculous valuation that raising equity is probably off the table, so just how you're thinking about cash flow and capital structure going forward.

Mike Carlet: Sure. So we continue to target, like we've always said, that's sort of 3x leverage in the business. I don't know over actually get to 3x leverage because we get close, we're going to sort of take it back up to fund something as we go forward. But fees are sort of target outlook as we think about the leverage piece. We did deploy a lot of cash this year -- this quarter and this year. If you look, it's not just in inventory.

You can see a lot of inventory growth. It's also, as you look that prepaid and other current assets. You could see a lot of deposits and prepayments and a number of other things that we kind of do to protect the supply chain. So we think that piece of it, we don't expect to grow. We're managing inventory at about 3x turns right now, which is in line with our historical averages. Obviously, during COVID, we had some things jump around and we've got back to sort of the normal run rate. The Staub acquisition put $4 million or $5 million of inventory on the books associated with that.

In Q1, it's typically our biggest use of cash. We pay the bonus payment in Q1. We have the Chinese New Year that we could build up inventory for. So generally, our cash flow cycle is going to see the most use of cash in Q1, even during normal times, and then we'll be a much higher cash generation during the rest of the year, and we expect that to continue. So we're very confident in the cash flow of the business. We think inventory is now in the right place for supporting our integrators despite the fact that there's a couple of dozen SKUs that are driving us all crazy. That we're going to continue to manage. And we think that will be generating the appropriate amounts of cash going forward off of our EBITDA.

CapEx is still for the year going to be in that $15 million to $20 million range. I think we mentioned we're moving our headquarters in Salt Lake City to a new location, which will -- depending on when timing is $5 million, plus or minus, and we think that will be this year it might lead into next year. But other than that, we feel really good about the cash flow outlook.

Operator: Our next question comes from Keith Hughes with Truist.

Keith Hughes: At the end of the release, you discussed the growth in the number of domestic integrators transacting with you and then the spends about 8.4%. Is that all driven by inflation or are you seeing something about the math there that's hiding some growth of realizing integrators increasing spend?

Mike Carlet: Yes. So if you think about last year, we did 2 price increases. One was about 1.2% in March, one was 5.8% plus or minus right around 6% in August. And so you sort of normalize those 2 things out, you would say price in last year's number didn't get a full year impact of all that, is somewhere around 4% or 5%. And so if we think about 8% growth in spend curve, you would say it's somewhere around half of it is probably directly related to price and the other half is volume associated with the average spend per integrator, which drove an 8.5% increase. And then again, as you just pointed out, 11.7% growth in the newer transacting integrators.

This year is going to be complicated. We have those price increases last year. We have the one we did in February, we'll have the 1 we did in June. So the numbers will obviously be very price impacted this year. But for last year, about half of the growth in spend was, we think, price related.

Keith Hughes: Okay. And final question, given the timing of the release in June, I assume there will be still in the second quarter, some contribution margin pressure from inflation. Is that correct?

Mike Carlet: Yes, absolutely. We would expect to see maybe a slightly better contribution margin in Q2, but nothing significant. And most of the benefit of that price increase will be in kicking in the beginning of Q3.

Operator: Our next question comes from Ryan Merkel with William Blair.

Ryan Merkel: I just wanted to follow up on that last point on gross margin. So when do you claw back the full 230 basis points of the negative price cost? Is that 3Q? Or does it take until 4Q?

Mike Carlet: We're not going to guide specifically on it, but I think we would expect to get most of the benefit by the third quarter. I think very little bit in Q2, but we think Q3 should see a return to those normal levels.

Operator: Our next question comes from Brian Ruttenbur with Imperial Capital.

Brian Ruttenbur: Just real quick, if you could go over any labor issues that you're seeing given inflationary pressures out there. And more importantly, maybe what your integrators are seeing because that's an important channel and how they're installing. Is there issues out there on the integrator side that's slowing you guys down?

John Heyman: Well, let me -- a couple of things. Labor is very tough. I think the starting point with that all is making sure your own team, your existing people are highly engaged. And I just actually looked at our engagement scores, they are at a record high. We did do a higher-than-normal wage increase on our own cycle in earlier this year. Our retention has been excellent even after paying bonuses for last year.

So feel good about all that, but we all remain very conscious of that. And integrators have been having a hard time hiring labor for the past 2 or 3 years. It's the #1 concern in the industry. And on top of that, they've had to fight COVID in their own businesses because they've had people out on COVID. And so I think that continues to be a struggle in the industry.

We're doing a number of things around efficiency of products and in terms of helping our integrators find labor that we're starting to work with. And so I think part of -- the #1 thing we can do in the short term is to continue to recruit more capacity around our installation capacity for our products, and that's why growing our integrator count has been really important.

So all of those things are important. I will say during COVID, a bunch of training things had to be shut down because people weren't able to get together. And so we're now

starting to utilize our local offices and starting to conduct more training sessions for new techs in the field.

So that was to my comment earlier. If there is some softening on the labor front, it may actually be an opportunity for our industry that's already operating kind of overcapacity.

Operator: At this time, this concludes our question-and-answer session. I'd now like to turn the call back over to Mr. Heyman for closing remarks.

John Heyman: Thank you very much. I really appreciate everybody joining us today. It's a really exciting time here at Snap One. Special thanks to our employees who continue to make outstanding contributions and the network of our integration partners who are doing great work in the field, driving exceptional experiences for individuals and businesses everywhere. And finally, thank you to our investors for your continued support. We look forward to speaking with you at the end of Q2. And operator, I'll turn it back over to you.

Operator: Thank you for joining us today for Snap One's Fiscal First Quarter 2022 Earnings Conference Call. You may now disconnect, and have a wonderful day.