Snap One Holdings Corp. (Q4 2022 Earnings)

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Corporate Speakers:

- Eric Steele; Snap One Holdings Corp.; SVP 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 Division, Research Associate
- Paul Chung; JPMorgan Chase & Co; Research Division, VP & IT Hardware Analyst
- Christopher Snyder; UBS Investment Bank; Research Division, Analyst
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PRESENTATION

Operator^ Good afternoon. Welcome to Snap One Holdings Corp.'s Fiscal Fourth Quarter and Full Year 2022 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, operator. Good afternoon, and welcome to Snap One's Fiscal Fourth Quarter and Full Year 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 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, March 14, 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^ Eric, thank you, and welcome, everyone, and thanks for joining us this afternoon. To begin today's discussion, I'll give some company background, followed by a review of our recent performance, and then I'll turn the call over to our CFO, Mike Carlet. Mike will discuss our financial results for the quarter and year in more depth as well as provide our outlook for 2023. After that, I'll share some closing remarks before opening the call for questions. Let's get started.

To begin, 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 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 growing local branch network.

We further support our integrator partners with our proprietary software platforms and workflow solutions to allow them to successfully serve their customers across the project life cycle. We are confident there is a tremendous and durable growth opportunity in front of us, and we are positioning our integrator partners to realize this growth with us.

We believe homeowners will continue to upgrade their existing technology. We know the U.S. is under housed by millions of homes that will be built in the future, and we are confident small business formation will continue to be the backbone of the economy.

It is inarguable that homes and businesses will become smarter over the next decade, and many will require professional help to integrate and support the technology they need. This is the #1 driver of our long-term growth, and no company is better positioned for this future than Snap One.

Our growth algorithm is simple. Continue to attract more integrator partners and capture more of their spend by building new products and driving adoption of our ecosystems. This formula will drive our growth over the next decade, and we will remain focused on executing this strategy while managing through the near-term uncertainty.

Turning now to our recent performance. Our team delivered solid fourth quarter results. And despite a challenging macro environment, we achieved strong growth in net sales

and adjusted EBITDA for fiscal year 2022. I am proud of what the entire team has accomplished as we navigated the ongoing impacts of a dynamic operating environment while continuing to deliver for integrator partners.

For the fiscal year, we delivered $1.124 billion in net sales and generated $114 million in adjusted EBITDA, representing year-over-year growth of 11% and 3%, respectively. Our fiscal fourth quarter results exceeded the guidance we shared last time we spoke.

While the industry continues to reduce inventory levels in the channel, we saw integrator partner activity remain steady through Q4 as they worked against healthy backlogs in their own businesses. The channel inventory buildup helped sales in the first half of 2022, but has been a continuing headwind for us since then as integrators deplete inventory. Mike will elaborate on this dynamic in his remarks.

Looking back on 2022, a major focus for us was enhancing the smart living experience by improving both hardware and software offerings for our integrators and end consumers. At year-end and early 2023, we successfully introduced exciting new products across our outdoor entertainment lineup, linear lighting, control, surveillance and/or networking product categories.

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; and Episode Radiance, which builds on our suite of outdoor entertainment products. Importantly, many of our new products will drive upgrade opportunities for our installed base of end customers.

Our products and services garnered significant industry recognition in 2022, including 17 CE Pro Quest for Quality Awards out of 22 identified subcategories; 40 Top 3 brand rankings across 62 identified product subcategories in the 2022 CE Pro 100 Brand Analysis Awards; and 2 Mark of Excellence Awards at the Consumer Electronics Show in January of this year.

I'd also like to highlight a few strategic accomplishments across our business this past year. We continue to invest in and bolster our software and service offering. We released the Control4 OS 3.3.0 update; introduced the OvrC Connect app; and completed the acquisition of Parasol, a powerful 24/7 remote support service based on OvrC.

Two, our commercial and security growth markets remain important long-term opportunities for us, and we displayed continued progress in these areas in 2022. In commercial, we executed on product development, including the Control4 multi-display manager functionality that was voted in AV Technology, Best of InfoComm '22 Award winner. In security, we acquired home automation and security products provider, Clare Controls, and announced the upcoming launch of the new Luma x20 IP surveillance solution, which is now shipping.

Three, we expanded our omnichannel presence by opening 8 net new local branches in '22, including several in Q4, and acquiring two new branches in Canada through the acquisition of Staub. This brings the total number of North American branches to 41 as of year-end.

Four, further enhancing our omnichannel initiative. We have begun to convert our e-commerce customers to a single e-commerce portal, which will drive efficiencies in our business, make our integration partners' lives easier and allow us to drive marketing programs with higher efficacy.

We believe that we made significant progress with our strategy in '22 and are increasingly well positioned for a long-term smart living evolution over the coming years. Our position in the industry remains quite strong, and we are confident that growth in smart living adoption, the central role of the integrator in providing holistic solutions and our competitive differentiation will propel our long-term success.

As to the economy and its impact on our business, as we discussed last quarter, we saw some softening around our residential end market, resulting in lower sales volumes relative to the first half of '22. We continue to see signs of end consumer cautiousness and elevated levels of channel inventory, which impacted our integrator partners' purchasing habits.

Anecdotally, project delays and descoping are occurring as integrators seek to value engineer projects in response to a more price-conscious end consumer. Last quarter, we described our integrator partners had accumulated additional inventory in response to supply shortages. And we expected an impact of about $40 million to $60 million over the subsequent quarters as they rebalanced their own inventory positions.

Since our last call, we have leveraged our OvrC software to see when products purchased by the integrator are actually put into service. With the benefit of this added visibility, we now believe inventory in the channel peaked towards the end of Q2 of '22 but well above the high end of the range we've previously communicated. Since then, we have seen strong signs of destocking across the channel and expect to reach a normalized state in the second half of '23.

While the residential market remains a bit soft, our diversified business model allows us to serve integrator partners across a variety of end markets. These partners do remain busy and continue to prove their resiliency, showcasing their ability to pivot projects and adapt to the current environment.

Historically, their capacity has been a governor on our growth, particularly given the tight labor market, with demand for their services exceeding supply. So some contraction in end consumer demand can be absorbed by the channel given the ongoing capacity constraints.

Meanwhile, we continue to invest in the long-term growth of the business to extend our leadership position. However, given the uncertain macro backdrop, we have reviewed our long-term operating plan and prioritized investments in areas that we believe will position us for sustained long-term growth while curtailing spend in other places. Here are some actions we've taken.

Number one, we're eliminating inefficiencies in the business from the COVID time period. As input costs, freight rates and other supply chain factors normalize, we are driving an improvement in our contribution rate -- contribution margin rate, excuse me. Two, we expect more research and development efficiency by not having to redesign products in response to componentry availability challenges.

Three, we completed a strategic repositioning of our sales force to increase integrator partner coverage and identified other areas of efficiency in the business. And four, we're being diligent with costs in our business, ranging from warehouse, operation consolidation to reducing travel expenses.

Collectively, these changes resulted in a modest workforce reduction of about 3% in our business in the first quarter of 2023. I'm going to now comment briefly on our outlook, and then I'll turn the call over to Mike.

As we look to the rest of 2023, we expect the operating environment to remain challenging, particularly in the residential end market. In response, we have constructed an operating plan that reflects a heightened focus on delivering strong profitability and driving operating margin expansion. We are executing on controllable strategies consistent with our long-term growth algorithm that will enable us to outperform.

These include: one, increasing our share of wallet with increased -- with existing integrators through the adoption of our ecosystems and new products; two, continuing to innovate, invest in and launch exciting new smart living products; three, open new local branches; four, adding new integrator partners across our business, including in security and commercial markets, where we continue to see outsized growth; and finally, enhancing our software platform capabilities and introducing new software and service-based solutions.

Further, we intend to deliver this relative growth while driving scale in our operating model through improving our contribution margin rate as input and supply chain costs, such as freight, logistics, commodities and componentry costs, continue to normalize; moderating our investment pace to drive efficiency and optimize productivity; and finally, strengthening our balance sheet. We remain confident in our operating model.

And still, while demand has stabilized at current levels, persistent macro uncertainty causes us to take a pragmatic approach to our near-term forecasts. We are, therefore, setting our net sales and adjusted EBITDA guidance for '23 accordingly, and Mike will discuss this in further detail.

We believe our resilient integrator partners, our diversified business model and consistently strong execution will continue to position us to prosper in a dynamic macro environment. Mike, with that, I'll turn the call over to you to discuss the fourth quarter and full year financial results and '23 outlook in greater detail.

Michael Carlet^ Thanks, John. So I'll turn now to our financial results for the fiscal fourth quarter and for the full year ended December 30, 2022. Net sales in the fiscal fourth quarter decreased 1.9% to $268.2 million from $273.5 million in the comparable year ago period. The extra week in fiscal fourth quarter 2021 added approximately $17.9 million in net sales, and excluding that extra week, net sales increased approximately 5%.

For the full year ended December 30, net sales increased 11.5% to $1.124 billion, up from $1.008 billion in the comparable year ago period. Again, the extra week in fiscal '21 added $17.9 million. So excluding that extra week, net sales increased approximately 14%.

The growth in net sales during the quarter and year reflects several drivers. First, organic growth, including higher selling prices, resulting from price adjustments enacted across our product portfolio in 2022. The collective ramp of 8 net new local branches opened in 2022 also contributed to organic growth.

Several of these branches were opened in the most recent quarter, bringing the company's total local branch count to 41 as of year-end. Additionally, the company benefited from incremental sales contributions from Staub, which is acquired early in 2022.

Now let me talk for a minute about the impact of channel inventory. As John noted in his comments, we have performed additional analysis to refine our view and channel inventory amount and the timing of that inventory coming in and flowing out.

Based upon our visibility into the time line from when a product is shipped from our warehouse to when it is installed and activated within our OvrC software, we now estimate that channel inventory began to build in 2021 and peaked at over $100 million towards the end of the second quarter of 2022 before beginning a steady unwind.

For full year '22, we estimate the in-year impact was a net $25 million to $30 million benefit to our top line results as the sell-in that occurred during the first half of the year was partially offset by the sell-down in the second half of the year. On a year-over-year basis, the channel inventory impacts were approximately the same in '21 and '22, meaning there was an insignificant impact to the top line growth rate. However, the channel inventory impact was much more pronounced in the fiscal fourth quarter.

We believe between $15 million and $20 million of destocking that occurred in Q4 of 2022, representing an approximate 10% to 15% headwind to year-over-year growth in the quarter as we lapped inventory loading activity in Q4 '21. As John noted earlier, we anticipate continued channel destocking of about $15 million to $25 million per quarter

over the first three quarters of 2023 before reaching a normalized state in the second half of the year.

Turning now to contribution margin. One of the most significant drivers of our '22 financial performance was the impact of a challenging supply chain environment. Inbound freight rates, ship shortages and other supply chain challenges persisted throughout the year and required significant effort and expense to overcome.

We began to see an improvement in the second half of '22 and anticipate supply chain normalization in '23. With that said, our contribution margin, a non-GAAP measurement of operating performance, decreased 0.1% to $105.8 million or 39.4% of net sales in the fiscal fourth quarter from $105.9 million or 38.7% of net sales in the comparable year ago period.

On a dollar basis, the flat year-over-year contribution margin performance reflects the modest decline in net sales and continued product mix shift to third-party products, which typically carry a lower contribution margin as a percentage of net sales relative to our proprietary product. These factors were partially offset by the higher selling prices and improvement in the supply chain environment in the fourth quarter as compared to the remainder of the year.

In the fiscal fourth quarter, third-party product sales represented 35.3% of net sales compared to 32.2% in the comparable year ago period. Contribution margin as a percentage of net sales improved by 70 basis points on a year-over-year basis, driven by higher selling prices, net of product costs, mix and supply chain impacts.

For the full year 2022, contribution margin increased 8.1% to $441.2 million or 39.3% of net sales, up from $408.1 million or 40.5% of net sales in the comparable year ago period. On a dollar basis, the increase in contribution margin was driven by the net sales growth, partially offset by the continued product mix shift to third-party products.

For the full year '22, third-party product sales represented 32.2% of net sales compared to 30.3% in the comparable year ago period. Contribution margin as a percentage of net sales declined on a year-over-year basis due to product cost, mix and supply chain impacts, which was offset by the higher selling prices that were enacted.

Selling, general and administrative or SG&A expenses in our fiscal fourth quarter decreased 9% to $83 million or 31% of net sales from $91.2 million or 33.4% of net sales in the year ago period. The decrease in SG&A expenses was primarily attributable to the lapping of the extra week in last year's fiscal fourth quarter and lower variable compensation expense.

For the full year ended December 30, 2022, SG&A expenses increased 1.2% to $354.3 million or 31.5% of net sales, up from $350.3 million in the prior year or 34.7% of net sales. The increase in SG&A expenses during the year was primarily attributable to higher personnel expenses due to increased headcount from new local branch openings

and M&A, a resumption in pre-COVID travel and ongoing investments to support strategic growth initiatives, offset by lower variable compensation.

In fiscal year 2022, we also incurred the full year burden of public company costs and absorbed other costs associated with recently acquired businesses. Our net loss totaled $4.1 million in the fourth quarter compared to a net loss of $7.8 million in the comparable year ago period. And for the full year 2022, net loss totaled $8.7 million compared to a net loss of $36.5 million for the full year of 2021.

Our adjusted EBITDA, a non-GAAP measurement of operating performance, totaled $26.9 million or 10% of net sales in the fourth quarter 2022 compared to $26 million or 9.5% of net sales in the comparable year ago period. And for the full year ended December 30, 2022, adjusted EBITDA increased 3% to $114.1 million or 10.2% of net sales, up from $110.8 million or 11% of net sales for the full year 2021.

These changes in adjusted EBITDA were primarily attributable to net sales and contribution margin growth, offset by increased SG&A expenses. And a decrease in adjusted EBITDA as a percentage of net sales in the year 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, decreased 24.9% to $10.5 million or 3.9% of net sales from $13.9 million or 5.1% of net sales in the year ago period. And for the full year ended December 30, 2022, adjusted net income decreased 1.9% to $52.6 million or 4.7% of net sales from $53.6 million or 5.3% of net sales, again, in the comparable year ago period.

Finally, free cash flow, a non-GAAP measurement of operating performance, totaled negative $44.6 million in the fiscal year ended December 30, 2022, compared to negative $40.4 million in the comparable year ago period. The decrease in free cash flow was primarily attributable to capital expenditures associated with the build-out of our new corporate office in Lehi, Utah, new local branch openings and capitalized IT cost.

Net cash used in operating activities for the fiscal year ended December 30, 2022, was negative $23.1 million. This use of cash was primarily driven by an increase in inventory to protect against supply chain uncertainty. Our target inventory level, based upon our current demand, remains at approximately $275 million. And while we anticipate continued modest inventory growth in the first quarter of 2023, we remain confident in our plan to rightsize inventory levels this year.

At the end of the fiscal fourth quarter and full year 2022, we had approximately $104.1 million of liquidity, including cash and cash equivalents of $21.1 million and undrawn revolver capacity of $82.9 million. And just a few other KPIs that we had talked about on an annual basis.

We introduced a few annual key performance indicators or KPIs after fiscal Q1 of last year to provide enhanced visibility into key operating metrics. These KPIs regard the

count of transacting domestic integrators in the spend per transacting domestic integrator. And we'll continue to present these metrics on an annual basis.

In fiscal year 2022, we transacted with approximately 20,100 different domestic integrators who spent, on average, $45,500 each. On a year-over-year basis, the number of transacting domestic integrators and spend per transacting domestic integrator increased 0.5% and 9.6%, respectively. Over time, we have demonstrated the consistent ability to grow both our number of domestic integrators and our spend per domestic integrator.

Now before I turn the call back over to John, I'll take a few minutes to provide our financial outlook for fiscal 2023. 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 2023 guidance considers our full fiscal year '22 performance and our expectation that market uncertainty will persist throughout 2023. As such, we're taking a pragmatic approach to our outlook for the year as follows: first, we expect net sales in the fiscal year ending December 29, 2023, to range between $1.05 billion and $1.09 billion, which represents a decrease of 6.6% to a decrease of 3% compared to the prior fiscal year on an as-reported basis.

We believe the contributing factors to 2023 net sales change are as follows: first, an 8% to 10% headwind from the channel inventory destocking that we previously mentioned; second, we expect to see 2% to 5% organic growth, which includes pricing carryover from last year, local branch ramp-up and new openings; and three, a small 1% impact from recently completed M&A.

We expect adjusted EBITDA to range between $107 million and $115 million, representing a decrease of 6.2% to an increase of 0.8% compared to the prior fiscal year on an as-reported basis. Our adjusted EBITDA guidance reflects our commitment to drive incremental adjusted EBITDA margin expansion in 2023. We expect to achieve this both through contribution margin rate improvement as supply chain and input costs normalize as well as continued disciplined operating expense management.

And as we think about quarterly trending in 2023, we expect our year-over-year net sales change in Q1 to be down mid- to high teens on a percentage basis, and our top line growth rate to sequentially improve each quarter over the course of the year. We anticipate a return to year-over-year growth in the second half of the year as we work through this channel destocking.

We expect contribution margin rate to improve quarter-over-quarter in Q1 '23 versus Q4 2022 and to continue to sequentially improve during the year. This contribution margin rate improvement reflects the realized and additional anticipated supply chain and input cost normalization.

From an adjusted EBITDA perspective, we expect adjusted EBITDA margin compression year-over-year in Q1 '23 to mid-single digits given the lower net sales, followed by a return to year-over-year adjusted EBITDA margin improvement for the remainder of the year as we realize the contribution margin rate expansion.

And finally, 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, 2022, through the end of 2023. As of December 30, 2022, we had repurchased approximately 269,000 shares of our common stock at an aggregate value of approximately $2.9 million.

Consistent with our capital allocation policy, we will continue to prioritize in this order: a, our balance sheet strength; b, our organic growth investments; c, accretive M&A opportunities; and finally, our opportunistic share repurchase program. That completes my summary. John, I'll turn the call back over to you for any additional commentary.

John Heyman^ Thanks, Mike. A few concluding thoughts before we take Q&A. First, for 2023, just to reiterate, we have confidence in our proprietary product launches, the growth in adjacent markets such as commercial and security, our local branch opening strategy and the benefit of last year's pricing adjustments. We also anticipate returning to our favorable contribution margin rate trajectory as costs related to the supply chain continue to alleviate, and we execute in line with a disciplined operating expense model.

Second, we remain committed to our strategy. This includes new product launches. This includes software investments and platform developments, all in service of supporting our integrators 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 all homes and 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're investing in scaling our operations and platforms to drive better solutions for the end consumer, more capacity for the integrator and growth for Snap One in a way that increases our operating margins over time.

We believe the actions that we took at the close of '22 and so far in '23 have prepared us to succeed in this environment while also positioning us for longer-term sustainable growth. And with that, operator, please open the call for Q&A.

QUESTIONS AND ANSWERS

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

Erik Woodring^ So maybe just to start on the annual disclosures that you provided. The 1,000 net new integrators in 2022, can you maybe just unpackage that a little bit and help us understand maybe where some of those integrators were added, maybe where some that you transacted with in 2021 didn't come back in 2022, and then how you plan to kind of accelerate that growth on an absolute basis in 2023.

And just -- I'll include my follow-up with that, too, is when we think about your guidance for 2023, kind of what underlies that guidance when we think about the number of transacting integrators and then spend per integrator.

John Heyman^ This is...

Michael Carlet^ Erik -- go ahead, John.

John Heyman^ Go ahead, Mike.

Michael Carlet^ Well, Erik, first, good to see you last week. I'll start, John, and then you feel free to jump in. First of all, just to be clear, the number increased by 100 from 20,000 to 20,100, not by 1,000. So a relatively small increase year-over-year in the number of transacting integrators.

As we think about that growth, we continue to see good growth in security and commercial. We actually saw a little bit of contraction in the home AV side of the transacting integrator account, which is not surprising given the market that was out there, given the way the supply chain moves and knowing that we have a long tail of integrators that spend relatively small dollars with us.

So that number in there with the churn of that lower integrator count doesn't really concern us. Last year, we were more focused on spend per and pricing with all the supply chain challenges that were there. And as we think about next year and how it flows through, as John mentioned, clearly, next year, we're prioritizing our share of wallet and growing our base -- our sales with our existing partners. We're certainly not giving up on adding more tiers.

In fact, just given the normal churn in the business, every year, somebody is going to retire, somebody is going to sell their business. And so we know that we need to add over 1,000 integrators just to stay flat, and we expect to see that happen.

But when we build our model for this year coming up, we're expecting integrated count to be relatively flat, most of our sales increase to be coming from spend per integrator and share of wallet. But for the future, as we think about our long-term growth algorithm, we do expect both to be equivalent contributors to our long-term growth.

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

Paul Chung^ So just wanted to ask about some of the feedback from integrators for the year ahead. I guess, some competitors were kind of talking about rebounding order kind of growth in February and March. Are you seeing that? And then what are new products our integrators like the most excited about from kind of the new product portfolio and which areas are they seeing some softening demand?

John Heyman^ Sure. This is John. The -- you had a few questions packed in there, but let me try to answered them all. I'd say we saw -- rather than rely on anecdote, we try to rely on survey data. And we saw a, what I would call, mild decline in integrator sentiment that translated into their backlogs. But the backlog still remain healthy, and the sentiment still remains positive.

That decline we saw at the end of last year into January, we saw it turn upwards in February. So that's a positive signal, number one.

Number two, and that's on the industry as opposed to our product. I think on our products, the excitement that we're seeing around our new Luma surveillance product, our previous Luma product was a bit old in the tooth. And so we're seeing great excitement around that and the software platform that underlies that.

Our Halo remote line that offers a host of capabilities to the end consumer, including voice control, I think, is something that consumers are already providing great feedback on. And integrators are really excited because it's a family of products as opposed to one, so it allows them to meet a variety of budgets.

I'd say the Radiance outdoor product line is kind of a one-of-a-kind product that combines lighting and audio, great reception around that product, but that's something that comes more in the spring, and kind of our -- a host of our lighting products. So I think we've created a significant amount of excitement. We view those as fairly incremental to this year's sales.

Many of those products are replacing other products that we already have. But we think they're critical to integrate our adoption and share of wallet over the coming years. So really feel good about that. And we haven't had any negative response to any of those products.

I would also say we had a major OvrC release during the quarter that is now out in the market. And after some pains of any kind of change management that comes with software adoption, that's been really well received. I am not seen in our sales data or, anecdotally, any products that our integrators are shying away from in terms of categories of products, et cetera.

So the product development team has done a great job. I think across the Board, we feel like we're the leaders in many of these product categories, the awards I've mentioned speaks to that. And I feel like we've only upped the game with the products we're introducing.

Paul Chung^ Great. That's super helpful. And then just a follow-up. How do we think about the kind of the product mix on the top line throughout the year, integrated versus domestic versus international mix? And then can we start to see possibly some RMR revenue this year as well?

John Heyman^ Mike, why don't you take the mix question. And on the RMR side, we are -- we already have low 8-figure RMR revenues in the business. So that comes from our Parasol service offering and our 4Sight software offering. We've spoken about the huge opportunity in front of this industry to deliver against a recurring revenue model. And we think it's a very healthy model, aligning the end customer with the integrator with us.

We are in market testing right now with integrators with that product line, and we'll continue to keep you guys abreast of that. But we're seeing generally very favorable response and extending our end market testing with a few more integrators as we speak. Mike, do you want to talk to the mix question?

Michael Carlet^ Sure, John. I think as we talk about 2023 and how we're thinking about the business, within the model that we talked about in our guidance, we would say that we expect the 1P/3P mix to remain relatively flat in 2023 versus 2022. We expect there will be some adoption of new 3P products. We're going to continue to drive share of wallet of our proprietary products.

Now we think that there are certain initiatives that we're looking at that are not in our guidance right now or not in our models that we may or may not choose launched. That could change that mix, but that would be incremental to how we thought about the existing model.

Today, the vast majority of our business is our domestic integrator business. It's over 85% of our business today. That might even grow a little bit. I think the international markets remain a little bit more challenged just with some of the issues going on in Europe and some other challenges that are there. So I do think you see our domestic partner business as an overall share of our business increase slightly in the coming year.

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

Christopher Snyder^ And I appreciate all the guidance. Certainly not an easy macro to guide in, but I was just hoping for me a little bit more color on what macro assumptions underlie the guidance. Because it seems to suggest a further deterioration in the resi backdrop. Because I'm looking at Q4, and I adjust for days and the inventory headwind you guys provided, it seems to suggest about low double-digit organic growth versus the 2% to 5% guided for in '23?

Michael Carlet^ Sure, Chris. Yes. So I think as we think about 2023, if I was going to think about components of growth, and I'll talk about roughly around the midpoint of our

guidance range. 2% to 3% of that will be pricing, most of which is carryover from the pricing we already did last year. Very minimal pricing impact this year. We announced about a blended 0.5 point price change on February 1 that just took effect this week. And that's really the only pricing activity as we sit here today that we anticipate in 2023.

We think our new local stores and the ramp-up of local stores will drive another 2% to 3% growth. The biggest headwind out there, as we talked about, is that inventory number, which is going to be around a 9% headwind, maybe 10%, maybe 8% depending upon how that destocks or where it falls out.

There's a really small piece of carryover M&A from last year of about a point. And so if you do all that, what we're left with from volume is a down 2% to 3% from just a market standpoint. And we're looking at that saying, what we're hearing from our integrators is while they still have good backlogs, the backlog's a little bit lower than it used to be.

We believe the capacity issue that's there, but we do think there'll be some integrators at the bottom end, maybe not. Mostly the backlog dip into less than full capacity, which may drive some small decreases in the overall market. So we are assuming that the market will see some small contraction this year as housing activity and remodel activity remain a bit challenged.

I think that's probably the biggest variable out there as we think about what's going to happen for the full year. I think we feel really good about our visibility into the other numbers. And I think this sort of volume number and the market backdrop and our ability to capture share of wallet during that time frame is going to be where we really see performance can be up to how we're able to perform and then what does the market do with the macro that's out there.

Christopher Snyder^ No, I appreciate all that color. And then for my follow-up, kind of maybe a longer-term one, and it's on the integrator count. It didn't really grow in '22, obviously, a very tight labor market. But what gives you guys confidence over a multiyear basis that, that can be driven higher? And does that present any risk to the longer-term growth algorithm?

John Heyman^ This is John. It's a great question, Chris. We feel strongly that there's a significant market, tens of thousands of integrators who we don't do business with today. Many of those are in the security and commercial sector, but there's others as well who are buying smart home technology.

And I would just say, last year, our sales force was intensely focused on helping integrators find product because of the supply chain. So the notion of being able to go out and recruit new integrators was just something they didn't have time for. And second, in some areas, we were concerned about inventory availability.

And so I feel like our acquisition efforts were hampered a bit last year because of that. We're looking forward to getting back to normal with the acquisition programs that have

worked for this company for a decade, where we're able to recruit 2,000 to 3,000 new integrators annually.

I would say as we approach this year, 2023, I feel like we are focused on driving higher operating margins. The best way to do that is sell what you got to the customers you got. And that is where our biggest focus is around share of wallet.

As we get comfortable with the operating environment, we will then turn on the acquisition machine in a more intense manner. But we know that there are tens of thousands of integrators to attract to our business platform and our product offering.

Christopher Snyder^ Appreciate that, John.

John Heyman^ A big piece of that is continuing to open local branches. Again, we couldn't fulfill inventory in all those local branches, so those were delayed to the end of last year. And we'll continue to open local branches this year to serve all our partners in the different verticals we do business with.

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

Adam Tindle^ Okay. Maybe, John, and for Mike as well. I just wanted to start with the 2023 guidance, which I appreciate, more about the cadence of the year. I'm sure we'll get questions on this tomorrow. So I think you've mentioned a mid- to high-teens decline in Q1 with an expectation to return to year-over-year growth in the back half of the year. So sort of this kind of hockey stick type of shape to the year.

Just wondered if you could maybe cover the levers to that. Any time you've got that acceleration as the year progresses, investors tend to get a little bit nervous about that expectation moving forward. So maybe you could cover the levers to that improvement as the year progresses.

Michael Carlet^ Yes. No, great question, Adam. Definitely, there -- we're not going to guide the quarter specifically, but let me give you some directional numbers. I think, clearly, the biggest number we're using to predict here is this inventory in the channel and the year-over-year impacts. How did inventory come in last year? And how is it going to come out this year as we think about that year-over-year?

And so the way we're looking at it right now, our best guess is going to be about a 20% headwind in Q1, somewhere around the 20% headwind in Q2, a slight headwind, a couple of points in Q3 because, again, once we get to Q3, it was coming out in 2022, and it's going to come out at '23. So on a year-over-year comp basis, it's a less significant issue.

And then by the time we get to Q4, if our model is right and all of it comes out in the first 3 quarters, then by the time we get to Q4, it will be about 6% positive on a year-over-year

change basis as we lap the inventory that came out this year. And our model says that it should be pretty much fully wound through by the end of Q3.

Now there's a bunch of regression analysis and science in that, and it's a forecast, so I don't want to get too tied to exactly those numbers. But that's at least the way the model is and as we think about the quarterly moves. That's by far the biggest number that's out there.

The other thing that impacts, obviously, the pricing changes we did last year were done in February and done in June, and they're going to impact much more in the first half of the year. So 3%, 4%, 5%, 6% in Q1, Q2 and much more flat impact from pricing in the back half of the year. We'll only get the benefit of this year's pricing activity.

And then everything else is pretty much standard across the board as you think about it, but there's not a lot of variability on the other numbers. New stores ramp up pretty evenly throughout the year. The volume assumptions, there's a couple of points of difference in each quarter depending upon how we think what happened last year, what was going on with stocking levels. But generally, the rest of the numbers are pretty equivalent throughout the year.

Adam Tindle^ Got it. That's helpful, Mike. And maybe if I could flip the question on instead, from a balance sheet perspective. I think as that inventory comes out, if I understand the business model correctly, that, that will actually be a tailwind to cash flow. And sorry if I missed it, but if you could maybe cover your cash flow expectations for the year, and any expectations on the progression of that would be very helpful.

Michael Carlet^ Sure. We don't specifically guide cash flow, but I'll give you just some highlights and overview of where we think we'll be. Certainly, from an inventory standpoint, we ended the year with over $300 million of inventory. It's going to continue to creep up in Q1 this year as we think about Chinese New Year and just stocking for that and just the cadence of bringing product in.

But our ops team has been working really hard to get that rightsized, and we've got some internal targets. But at least as we think about it and talk about externally, we think $275 million is about the right number for where we think we need to be given current demand. And we think we'll be there by the second half of the year, whether that's the end of Q3, the end of Q4 depends upon some timing, but we do see that.

So throughout the year, as we think about that inventory balance dropping by $25 million or $30 million, that will certainly be a source of cash and a tailwind to cash flow. Other than that, our cash flow, we think, will be very, very normal with our adjusted EBITDA, not very much else going on with working capital outside that inventory number. Our normal level of CapEx, we've got a couple of million dollars more left in our Lehi office relocation. We've got a couple of million dollars of work that we're doing around our IT systems and consolidation.

But other than that, excuse me, the normal activity that we have, with the caveat that as we always talk about, don't forget that TRA that's out there. We made our first TRA payment recently this year. That was about $11 million that was made in Q1. There's still $111 million liability on that. We don't have another payment to make until Q1 of next year, but we did pay $11 million towards the TRA in Q1 this year.

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

Keith Hughes^ I had a question on the destocking we talked about a lot here. Is there specific products that you think are really heavy in the channel? And then on that, how do you sort of gauge where channel inventory is? How is that actually done?

Michael Carlet^ Yes, it's a great question, Keith. John, I'll jump on this, and then feel free to add any color if you want. I think as we talked about it last time and last quarter, and as we talked about, this was never a big issue in our channel historically, something we had not paid a lot of attention to. Our partners, 20,000 integrators out there buy product today, and they're typically installing on a job next week, next month as that job is going to completion.

I think what we think and what we believe is as the supply chain really became challenged, as integrators and our partners found it more problematic to find products, if they can't get their hands on product, they can't complete a job, they can't get paid. And so they look for those products that had the most risk of stocking out, that had the lowest replaceability, that had the highest switching costs and said we're going to start thinking about stocking up on them.

So things like control systems, things like your network system, you OvrC, your remote management system products are the ones that are there. And so the way we sized it last time was we went out, we did a bunch of survey work with our partners and asked them how much has your inventory grown. We also look very specifically at our control products and look at how many controller shipments do we have versus how many were installed and took that differential and tried to extrapolate. So that's where we came up with the numbers we talked about last time.

But knowing the magnitude of this issue and trying to be more scientific about it, our product team and our ops teams went hand in hand and started doing a bunch of really good work. And whenever we ship a product that is OvrC-enabled, when that box leaves our warehouse, we're doing an outbound scan on that product for warranty purposes and to record that it went out the door.

Tying that together with the data that comes from OvrC, we know when that exact box and SKU comes online for the first time, and we can measure that time frame. And all that can be measured now, we can go back and look historically. And so we asked our teams to go back and look and say, "Wait, what was the average time between when a product left our warehouse and it got installed".

Now again, this only works for products that come online that do have that connectivity. So we went back and looked at those products, again, primarily our controllers, our networking, our IP power, our surveillance products and measured that time frame. We will then see how did that time frame expand. And you can see it is starting to expand about the middle of 2021, and it kept expanding all the way up to the middle of 2022. And now we can see that curve coming down and the time frame contracting.

So we're using that, and that's where we come up with that regression to project what's going to happen in 2023. I can't guarantee you it's all going to come out. We still have a thought that maybe some of it stays there. But those are the main products. In addition to those proprietary products, we then sort of say what other products that don't connect or that are third-party products that might also be there?

So things like AVRs were really tough last year. We know some of the streaming audio products were very short of stock last year. And so we take the specific data that we have around our connected products, we put some extrapolation on how we think other products attach to that to come up with the overall numbers that we're talking about.

Keith Hughes^ Okay. And just one final thing. You had mentioned the impact in the first and second quarter. Is it net of 20%? Or was it 20 million? It was wasn't clear.

Michael Carlet^ What's interesting is, it's about the same thing.

Keith Hughes^ I'm looking at the numbers, yes, I get it, but that's one, Mike. Okay.

Michael Carlet^ Yes. Okay. It should be around $20 million, plus or minus, it could be $15 million to $25 million. Again, we're doing some analysis here, but $15 million to $25 million in each of the first 3 quarters.

But on a year-over-year basis standpoint, in Q1 and Q2, because inventory was coming in last year and coming out this year, the overall year-over-year change is going to be 18%, 19%, 20% each quarter. By the time we get to Q3, while it's still going to be $15 million or $20 million coming out, the year-over-year impact will be basically flat because that's the same thing that came out in 2022.

Operator^ (Operator Instructions) Our next question comes from Brian Ruttenbur with Imperial Capital.

Brian Ruttenbur^ I just wanted to follow up on a couple of questions. First of all, cash. So you're at $21 million and you anticipate -- I think that's where you ended the year, and that was down from third quarter. Can you anticipate an additional drop in first quarter and then a recovery in second quarter, third quarter? Is that correct? Just trying to understand the cash.

Michael Carlet^ Yes, that's right, Brian. We don't think about cash because we have a revolver. So we try to maintain our cash balance at the lowest minimal cash balance we

need and then use the revolver appropriately. And so we really think about it on that basis.

But yes, if you think about total liquidity, that's absolutely right from a timing standpoint. We ended with $21 million of cash. We had a revolver draw of about $12 million at the end of the year. That's going to be used somewhat in Q1, and then it will start recovering in Q2. So our low point of liquidity we look at in models should be the end of Q1.

Brian Ruttenbur^ Okay. And then one other question about revenue. You gave us very good guidance on first quarter. Second quarter will be down still dramatically year-over-year, pretty strong, maybe not as much on a year-over-year basis as first quarter. And then should third quarter be more of a breakeven on a year-over-year basis and then fourth quarter be slightly positive on a year-over-year basis? So I'm just trying to get the flow here.

Michael Carlet^ It's like you were reading off a cheat sheet there, Brian. That was very good. Yes. So second quarter won't be as bad as first quarter. Again, the impacts in the channel will still happen. But given some other things that are out there from a volume last year, from some volume expectations this year, some pricing activities last year and this year, it won't be as bad in Q2 as Q1, around flat in Q3 and then positive in Q4.

Operator^ Thank you. At this time, this concludes our Q&A session. I'd now like to turn the call back over to Mr. Heyman for his closing remarks.

John Heyman^ Thanks, Josh, and thanks again to everybody for joining us today. 2022 was, in many ways, unprecedented in terms of kind of an operating environment for many of us. And I just want to thank our incredible team at Snap One for their efforts and their efforts, specifically, in delivering for our partners who continue to do great work out there in the field. So thanks again, and I'll turn it back to you, Josh.

Operator^ Thank you for joining us today for Snap One's Fiscal Fourth Quarter and Full Year 2022 Earnings Conference Call. You may now disconnect.