08 - 08 - 2023

SmartRent.com, Inc.

Second Quarter 2023 Earnings

SmartRent.com, Inc.

Second Quarter 2023 Earnings

CORPORATE SPEAKERS:

Lucas Haldeman
SmartRent, Inc.; Founder, Chairman & CEO
Hiroshi Okamoto
SmartRent, Inc.; CFO
Brian Ruttenbur
SmartRent, Inc.; Senior Vice President of Investor Relations

PARTICIPANTS:

Shek Ming Ho
Deutsche Bank AG; Analyst
Ryan Tomasello
Keefe, Bruyette, & Woods, Inc.; Analyst
Erik Woodring
Morgan Stanley; Analyst
Thomas White
D.A. Davidson & Co.; Analyst
Brett Knoblauch
Cantor Fitzgerald & Co.; Analyst

PRESENTATION:

Operator^ Good afternoon. And welcome to the SmartRent Second Quarter 2023 Earnings Call.

Please note that this call is being recorded. (Operator Instructions)

I would now like to turn today's call over to Brian Ruttenbur, Senior Vice President of Investor Relations.

Please go ahead.

Brian Ruttenbur^ Hello. And thank you for joining us today. My name is Brian Ruttenbur, Senior Vice President of Investor Relations for SmartRent.

SmartRent.com, Inc.

Second Quarter 2023 Earnings

I'm joined today by Lucas Haldeman, Chairman and CEO; and Hiroshi Okamoto, Chief Financial Officer. They will be taking you through our results for the second quarter of 2023 as well as discussing guidance for the second half of the year.

Before today's market open, we issued an earnings release and filed our 10-Q for the three months ended June 30, 2023, both of which are available on the Investor Relations section of our website, smartrent.com.

Before I turn the call over to Lucas, I'd like to remind everybody that the discussion today may contain forward-looking statements that involve risks and uncertainties.

Various factors could cause our actual results to be materially different from any future results expressed or implied by such statements.

These factors are discussed in our SEC filings, including our annual report on Form 10-K and our quarterly report on Form 10-Q.

We undertake no obligation to provide updates with regard to the forward-looking statements made during this call, and we recommend that all investors review these reports thoroughly before taking a financial position in SmartRent.

Also during today's call, we will refer to certain non-GAAP financial measures.

A discussion of these non-GAAP financial measures, along with the reconciliation to the most directly comparable GAAP measure is included in today's earnings release.

We would also like to highlight that the second quarter earnings deck is available on the Investor Relations section of the website.

And with that, let me turn the call over to Lucas to review our results.

Lucas Haldeman^ Good morning. Thank you for joining our call.

I'm pleased to report we had another strong quarter with both revenue and adjusted EBITDA within our guidance range. We grew total revenue by 26% year-over-year to more than $53 million, and we improved adjusted EBITDA to negative $6 million, an increase of over $2 million sequentially from Q1 and more than $13 million from Q2 of 2022. This marks the fifth consecutive quarter of improved adjusted EBITDA, primarily driven by a combination of higher gross margin and tight controls on operating expenses.

In the second quarter of 2023, we saw notable improvement of our gross margin to more than 18% versus 2% last year as both hardware and hosted services gross margin hit record highs in the period. As expected, professional services gross margin decreased compared to last year. While each quarter is impacted by the mix and timing of deployments, we anticipate

improvement in professional services gross margin as well as our total gross margin in the second half of 2023.

Our operating margin continues to expand as we control overhead expenses and drive toward profitability. We are reiterating our goal of achieving adjusted EBITDA breakeven by year-end and cash flow breakeven within the following 6 months.

I'd like to turn now to new announcements and product developments for the quarter. Today, we shared that we have a new agreement with ADI Global Distribution to serve as our preferred distribution partner. This agreement strengthens our competitive position, providing enhanced flexibility and ability to scale without impacting our working capital. Additionally, it enables us to convert fixed costs into variable costs while also reducing the financial exposure we have in months with lower volume deployments. If you refer to Slide 8 of our quarterly investor presentation, we provide a brief overview of our arrangement, which will provide us with needed hardware on demand while reducing our cash investment and inventory.

At the end of Q2 2023, we had over $60 million in inventory. And as a result of this agreement, we expect our cash to increase as we transfer a large portion of our existing inventory to ADI. Our customers will continue to receive products in a timely manner, while we remain focused on the innovation and product enhancements that keep us at the forefront of our industry.

Last week, we announced a preferred resale agreement with Position Imaging, the leading provider of smart package room solutions. Smart package rooms complement and expand our offerings and address a major pain point for rental housing operators.

Using patented technology, the smart package room solution guides careers through a log-in process that automatically directs residents to their packages. This solution relieves on-site associates from the time-consuming process of packaged storage and distribution. Smart package room is enhanced by our existing products like Alloy Access and work management and solves many of the industry's long-standing package management issues while modernizing the renter experience.

During the quarter, we publicly announced the rollout of our community WiFi solution, which we discussed on our last call. SmartRent community WiFi is different from traditional Internet service providers because it integrates seamlessly with property management systems, creates a secure community-wide private network delivers immediate connectivity to residents through our SmartRent Resident app and provides an additional revenue stream to our customers, all while delivering an enhanced resident experience.

Given the many benefits, we view community WiFi as a large addressable market opportunity for our company.

On Slide 9 of the presentation, we provide an example of anticipated community WiFi economics based on the deployment of a 200-unit apartment community. We have robust

demand for our solution and a large percentage of our customers are looking to incorporate our offering. Community WiFi is complex and has a long lead deployment time, and we expect to see revenue contribution beginning in 2024 with more significant revenue traction in 2025. The relationships we've built and the insights we gain from our clients are invaluable in informing our strategic areas of focus and product road map. The offerings we discuss today, Community WiFi and smart package room solved for pain points and needs that our clients share with us.

I'd also like to provide an update on our channel partner program that we launched last quarter. This program gives us greater ability to expand our influence with small and midsized business prospects in the long tail, which we view as a critical revenue driver. Our channel partner network has grown, and we have onboarded and trained partners in 41 states who are actively bringing new opportunities to SmartRent. We are pleased with the groundwork we are laying in 2023 to make this a meaningful revenue vertical in 2024. We I will now turn the call over to Hiroshi to review the financials in more detail.

Hiroshi Okamoto^ Thank you, Lucas. We had another solid quarter of revenue growth, expanding margins and narrowing adjusted EBITDA loss as we continue to execute on our path to adjusted EBITDA profitability by the end of the year. I will provide updated guidance for the rest of the year. But before that, I'd like to dive a little deeper into 4 areas that Lucas touched on. that should help in understanding where we currently are as a company, revenue growth, gross margin, profitability and cash optimization.

Total revenue for the quarter was $53 million, down as anticipated from an exceptionally strong Q1 with a solid 26% increase from Q2 last year. Combining the first 2 quarters, revenue was $118 million, up 49% from $80 million for the first half of 2022. By revenue stream, hardware revenue was $28 million. Professional services was $10 million and hosted services was $16 million. The composition of our revenue continues to change as the company evolves, but I would like to highlight that we expect SaaS revenue to continue to increase every quarter as we deploy more units and more products that generate a steady flow of additional software subscription revenue.

A key metric for us is SaaS ARR, which increased from $36 million in Q1 to $39 million in Q2, an increase of 8% sequentially and 27% year-over-year from $31 million. Unlike the steady buildup of SaaS revenue, hardware and professional service revenues will fluctuate quarter-to-quarter as the velocity of unit deployments varies. This quarter, we deployed 48,000 units, pushing total units deployed to over 650,000. Hardware and professional services ARPU declined from the heights we experienced in Q1 because of differing product mixes in the quarters with the annualized trajectory of ARPU for hardware and professional services remains positive.

Hardware ARPU increased 13% from Q2 of last year, and professional services increased 39% compared to last year. Our scale and credibility built over years allows us to drive revenue based primarily on the value of our solutions as the breadth of our offerings now far exceeds any other company in the industry. There is ample organic opportunity to upsell and cross-sell our

expanding suite of products and our entry into other promising areas such as community WiFi will drive higher ARPU.

Now turning to gross margin. Total gross margin increased from 14% in Q1 to 18.5% this period. On a year-over-year comparison, gross profit increased roughly $9 million from under $1 million in Q2 2022. Hardware margins surpassed 20% for the first time, up from 13% last quarter and a negative percent last year. The dual effects of increasing ARPU and decreasing costs through initiatives to improve efficiencies in manufacturing, logistics and distribution are resulting in expanding margin. Professional services margin declined sequentially to negative 57% from negative 38% because of reduced unit deployments during the quarter.

We are working on long-term initiatives to reduce our fixed cost basis and believe that professional service margin will improve significantly beginning in Q4 2023. SaaS margin increased to 75% in Q2 from 73% in Q1. Improving SaaS margin is a combination of increasing SaaS revenue gaining economies of scale and efficiencies and reducing costs supporting the SaaS revenue stream.

Next, turning to profitability. We are on track to become adjusted EBITDA positive in Q4. Adjusted EBITDA for the quarter was negative $6.4 million, an improvement of 24% from Q1 at negative $8.5 million. Compared to Q2 of last year, we saw a dramatic 68% improvement or in absolute dollar terms, an improvement of $13.4 million. Along with margin expansion, we have been aggressively pursuing ways to reduce operating expenses by improving internal processes, substituting technology to improve efficiency and accuracy and optimizing deployment of the company's resources to maximize returns.

Total operating expenses were reduced to $22 million in Q2 from $28 million in Q2 2022, a decrease of $6 million year-over-year. Cash burn is down considerably from the average quarterly burn of $20 million in 2022. Our cash balance declined from approximately $204 million at the end of Q1 to $197 million at the end of Q2, a decrease of about $7 million. We expect the AEI agreement will further reduce our inventory levels over time and will allow the company to deploy cash in other ways.

We continue to maintain an undrawn credit facility of $75 million and believe we will begin to generate free cash flow in 2024. Guidance for Q3, Q4 and full year 2023 are as follows: Q3 guidance for revenue is from $57 million to $62 million and adjusted EBITDA from negative $6.5 million to negative $4.5 million. Q4 guidance for revenue is from $58 million to $70 million and adjusted EBITDA from breakeven to $2 million. Full year guidance for revenue is from $233 million to $250 million, adjusted EBITDA from negative $22 million to negative $18 million.

I will now pass the call back to Lucas for closing remarks.

Lucas Haldeman^ Thank you, Hiroshi. We delivered results within guidance due to the marked improvement in overall margins and reductions in operating expenses and have now produced 5

consecutive quarters of improving profitability. The distribution agreement with ADI will fortify our inventory and distribution activities, streamlined inventory management, enhanced product availability and reduce costs. New offerings such as community WiFi will drive high-margin recurring revenue and further embed us with our clients and our growing channel partner network will continue to expand our reach.

With over 650,000 units deployed with our smart home technology, more than all our competitors combined, our market-leading position remains unchallenged. Our growth is multipronged through existing clients, new customers and our channel partner program. We see a bright future for rental housing and are proud to play an important role for our customers as they seek to provide smarter living and working experiences for their residents and site teams from protecting assets with leak sensors to creating operational efficiencies with work management and smart package room to helping our customers generate revenue with community WiFi and self-guided tours, our holistic solutions solve real challenges and are the reason we remain on the leading edge.

We are grateful to be the trusted supplier in our space and look forward to all that's on our horizon.

Operator, please open the call for questions.

QUESTION & ANSWER:

Operator^ (Operator Instructions) Our first question comes from Sidney Ho with Deutsche Bank.

Shek Ming Ho^ I want to ask about the guidance. So you are guiding fourth quarter revenue to be up about 8% at the midpoint, which seems to be better than normal seasonality. Why is it up this year? Is it the number of unit deployment? Or is it more because of hardware ARPU going up. Also, there is a big range for Q4. Is it based on some projects that may have high value or just a number of deployments that is uncertain. And then I've a follow-up.

Hiroshi Okamoto^ Yes. Thank you, Sidney. Let me take the first question first, which is our guidance that we provided is really based on different scenarios that we created. Q4 is a little bit wider than Q3 because it's a little further out. But in general, we expect revenue to continue to increase. The seasonality is something that still affects our installations. But as we've -- I think we've tried to explain in the past, there's a divergence between our units and our revenue. So even if units are flat, which were not -- we're not guiding to that. But even if it is, we continue to see revenue increase. So that's why you see that Q4 is higher compared to Q3.

Shek Ming Ho^ Okay. That's fair. My follow-up is on the professional services gross margin. It went down about 20 points quarter-over-quarter. I think Lucas in your remarks, you said that that's kind of expected, but the magnitude is still a little larger than I thought. Can you talk about what was driving that decline, especially when revenue was up and the team is focused on

improving that. any onetime events in that may have impacted the quarter. But more importantly, how are you thinking about the business breaking even by the end of calendar '24 per your comments last call. You talked about working on some long-term initiatives and maybe gross margin will improve significantly starting Q4. Can you give us a little more color on that?

Lucas Haldeman^ Yes. Thanks, Sidney. It's Lucas. I'll take that one. Yes, I think we did anticipate professional services margin to go down in this quarter. It's really on lower deployments in Q1 is what's driving that and the fixed costs that we have there. And the bright spot is exactly what you alluded to, which is we have a lot of initiatives that we've been working on some over a year now that are starting to come to fruition in Q3 and will really be felt in Q4. So that's part of where we feel really good about the guidance and we're on track to bring that professional services margin in line in a durable way going forward.

Operator^ Next, we have Ryan Tomasello with KBW.

Ryan Tomasello^ Just starting on the preferred distribution agreement, maybe you could just elaborate on the economics there. Should we expect any impact to hardware gross margins as that partnership ramps? And any just parameters around just how much order flow you expect ADI to oversee over time?

Lucas Haldeman^ Ryan, thanks for the question. Yes, I think we're pretty excited with this ADI agreement. I think it has really positive aspects on our working capital as well as our ability to continue to scale without outlaying capital. And over time, I think you'll see the bulk of our distribution will go there. We don't anticipate seeing a big effect on gross margin. We structured this in a way where it should be pretty much neutral to the P&L but has a great impact on cash and working capital.

Ryan Tomasello^ Okay. And then just unpacking the SaaS metrics a bit more, Hiroshi, appreciate the color there. But I guess nitpicking here, I'd say, the ARR growth decelerated sequentially while the SaaS ARPU declined quarter-over-quarter. And by our math, it looks like that might have been driven by the weaker some weaker performance on site plan, which can, I think, alter the ARPU, given there aren't necessarily units associated with that. So maybe you can just put a finer point around that math. And just more broadly, if you're willing to comment on where the structural growth profile could be for SaaS ARR over a multi-quarter period going forward?

Hiroshi Okamoto^ Yes. Thanks, Ryan. Kind of just to touch on site plan. We don't disclose it, but it's generally flat. So kind of the decrease isn't really due to that. I think the SaaS ARR, the ARPU is really just a function of a lot of different things, kind of the whole product mix and also kind of when in the quarter a unit comes online. So all those things could drive kind of the SaaS ARPU to go up or down a little bit. But I think the thing to look at is probably our year-to-date and really how it's increased over a more -- a longer period. So really taking 6 months for this year versus last year is probably a better way to look at it.

Operator^ Your next question comes from Erik Woodring with Morgan Stanley.

Erik Woodring^ Lucas, maybe I just want to ask on ADI again. Just to understand a bit more about the deal because I understand the offloading of inventory improves your costs, improve working capital, but I guess what is the incentive for ADI to take this business? I guess the way I'm understanding it is they're just going to be effectively reselling your hardware to your customers? Or are you targeting new customers? Because I was under the belief that ADI primarily sells to remodeling integrator. So just really trying to understand what the purpose is from -- in your view from the ADI side, why would they be taking this business, especially if there's no impact to your P&L, it seems like they must be incurring some costs or some fourth -- from taking this agreement. So I just want to double-click on some of those points, if we could, please. And then I have a follow-up.

Lucas Haldeman^ Yes. I mean I think the best way to think about it is we're currently utilizing multiple third parties, FedEx, UPS, DHL and forward stocking locations that will get replaced by ADI. So it's not that ADI doesn't make any revenue. It's sort of that it's neutral to us because we're already paying it to multiple third parties. The benefit to us is streamlined and accountability and the ability to do over time, do more than just a FedEx or UPS would be able to do for us. Because you're right, ADI does primarily service security integrators around the country and they have the ability to do things that we currently have to do in our warehouse like update firmware and put together kits for units. That gives us the ability to be more flexible with them going forward. So to be clear, I guess, not that there's no revenue for them. There's good revenue for them. And for us, it's just going to 1 partner set of multiple other third parties.

Erik Woodring^ Yes. Okay. That is super clear. That was the color I was looking for. If I just touch on another point, the units book number in the June quarter looked kind of unseasonably low, you'd have to go back to the height of the pandemic to really see 20,000 units booked in any quarter. And so was there something that happened in the quarter? Or is this evidence of perhaps customers being more cautious about the economy? Just want to make sure I understand if there's any onetime dynamics that impacted that number because it did look relatively low to your recent run rate. And that's it for me.

Lucas Haldeman^ Yes. It's a good question. I mean I think Q2 and Q3 historically are lower bookings quarters for us. I mean, budgets really get set in multi-family, mostly in Q3. So Q4 and Q1 are always higher bookings quarters for us. And I think you're also seeing a function of we had a really strong Q4 and a strong Q1, and we're not on pace to deploy double the units we did last year. And so some of that is just we have a good backlog that we're working through and customers don't sign new orders, so we fulfill the ones that they have in place. So I think it just -- it's sort of an anomaly that it came in where it is, but we feel still really good about the macro dynamic and the demand.

Operator^ Your next question comes from Tom White with D.A. Davidson.

Tom White^ Two, if I could. Just a follow-up on the professional services gross margins. Hiroshi, I thought you referenced maybe kind of tackling the fixed cost side of that part of the business to kind of improve gross margins? And then Lucas, I heard some commentary around some of the newer initiatives kind of helping with the deployed units and kind of tackling that gross margin way. Can you maybe just double click on that.

I'm just curious to the extent to which there are more kind of fixed cost changes there that you're going to make? Or is it just again more about scaling units deployed with some of these newer offerings? And then if I could ask you to kind of maybe talk a little bit about next year, even though I know you're not guiding, but presuming you guys get to cash flow positive next year. Can you maybe just give us like a little bit of a preview about how you're thinking about being able to sort of meaningfully ramp free cash flow margins versus continue to invest in not only a core business, but WiFi and things like that.

Hiroshi Okamoto^ Thanks, Tom. Let me try to answer that. The first part is really professional services. We know that it is a drag on our total profitability that this quarter, we did a negative $5 million for our gross profit from professional services and that is an area that we need to improve on. I think when we mentioned kind of fixed cost or variable costs, there's a lot that goes into that, lots of things that we're doing. But one thing is the increasing use of general contractors. So I think those are things that you'll see kind of hit the -- our results more in Q4 because these take time, but that's kind of the direction that we know we have to get to.

We think that we're going to have to get that to profitable gross margins over time in 2024, and that will lead to our adjusted EBITDA profitability as well as free cash flow as well. So professional services is definitely a big driver in that. Did that answer your question?

Tom White^ Yes.

Operator^ Your next question comes from Brett Knoblauch from Cantor Fitzgerald.

Brett Knoblauch^ I guess to start, can you maybe help me understand how you would look to maybe grow the number of units deployed in the quarter over the coming years, while also reducing the fixed cost base in professional services. Do you think you can grow more rapidly with, call it, increased use of general contractors and that would also be kind of margin accretive as well.

Lucas Haldeman^ Yes. I think -- Brett, I think you're spot on there that we're in general, 2 things are happening in professional services. We've been working, as I've talked about, on different technology initiatives that improve the efficiency. The other thing that happens is it improves the oversight of those installs, which allows us to lower our fixed costs and essentially substitute technology for for personnel that we have in the field today. And so you'll see some of that starting to come to fruition.

We've also matured to a point where some of the partners that we've been co-installing with have now installed so many thousands of units for us that they really don't need the same kind of oversights that they want fit. So you're seeing sort of this combination, this transformation happening this year of technology initiatives coming to fruition and sort of empowering us to use more variable costs and lower that fixed cost.

Brett Knoblauch^ Understood. And maybe just one other question on the build-out of community WiFi. I thought it was very helpful in the slide on the economics for that product. But I guess, how should we think about -- you guys are often gearing the business to get to breakeven on adjusted EBITDA basis now and assuming this product begins to ramp in, call it, the back half of next year and going into 2025, is there a lot of incremental costs you need to add on your end, whether it's in COGS or OpEx that could maybe slow the pace of adjusted EBITDA margin improvement? Or how should we think about those two kind of blending together?

Lucas Haldeman^ Yes. It's a good question.

I don't think you're going to see that happen. I think it's a relatively low initial cost for us to go in. The real big cost in WiFi, as you'll see on that Slide 9, is sort of the upfront hardware. And really, most of our customers are bearing that cost. They want to bear that cost and take the improved economics on their side. And so we do feel like we can scale up community WiFi without really a significant cash investment that, that would impact our margin. So I think it's kind of a win-win product for us.

Operator^ Next we have Sidney Ho with Deutsche Bank.

Shek Ming Ho^ I just have a couple of quick ones. So when I look at the SaaS ARPU and the bookings, it's good to see that jump in quite a bit to over $8 this quarter. Can you help us understand what's driving that? Is that primarily driven by products like the community WiFi so it's just that the mix of legacy customers maybe just a way down. And kind of related to that, is the ARPU and revenue. I see the ARPU and revenue was relatively flat to a question earlier. But how quickly do you think that will grow given the strength you're seeing in bookings?

Hiroshi Okamoto^ Yes. Sidney, I don't think I caught the second part of your question, but kind of the bookings, I think that's -- I'm glad you highlighted that. That is really kind of our efforts of cross-selling and upselling starting to show up. I think you'll -- a self-guided tour would be one of the products, also a lot of alloy access or common area access, those are showing up in the bookings ARPU there. The second part, I didn't, can you repeat that again?

Shek Ming Ho^ Yes. I was going to say, well, your ARPU in revenue was relatively flat the last couple of quarters. But given the booking strength that -- ARPU strengthen in bookings, how quickly do you think that will flow into the revenue side?

Hiroshi Okamoto^ Right. Yes. So that is -- it's kind of just a math equation, right? We do 47,000 units in a quarter, but there's 650,000 units out there. So it will take time for that to increase. But I think we saw that the bookings ARPU, that's a very promising sign for us.

Shek Ming Ho^ Okay. That's fair. And then a quick one here as well. Lucas, I think you talked about the community WiFi a little bit. Makes a lot of sense for your customers to adopt. But curious why we haven't seen the owners and operators asking for this solution sooner. And when it comes to future competition, what are the things that you believe set you apart? And how do you think it will take competitors? How long do you think it will take competitors to catch up?

Lucas Haldeman^ Yes. That's a great question, Sidney. I think on the competitive front, you can actually look throughout rental real estate and see just the cost of being second is incredibly punitive. It's very hard to catch up, if at all possible, to catch up to us. So I mean, I think every quarter that we continue to expand and grow our footprint and grow our governance, you're seeing that it gets harder and harder to catch up. And sort of the -- I think the question is sort of why our WiFi versus others and really it comes down to a couple of factors. And I mentioned a little bit on the call but give you a little more color. I think if you kind of think about it, our app, if you download the SmartRent app as a resident, everyone download that app is your key, how you get into your apartment.

So instead of getting handed the keys, you get handed the app. And so we have this unique marketing time where we can say, hey, here's your key. Next step is choose your password for the Internet.

So we create this incredibly seamless and elegant onboarding experience that takes all the friction out of getting the Internet set up. But if you think about one of the most frustrating parts of moving is not having internet and waiting for the cable company to come in and taking a day off of work, all that friction is removed with our solution. At the same time, we're providing new ancillary revenue to our customer base. So it's sort of this perfect combination. And I can't really opine on why has taken this long for this to catch on in multifamily. That's sort of a philosophical question that I'm not sure I have a good answer to, but it's incredible the demand we're seeing for it now and the shift that's happened.

It's really kind of coming out of COVID still where owners really realize that they have to care a lot about the Internet. And not to say they didn't before, but I think it was sort of thought of -- thought of as sort of an ancillary item and not sort of how you go to work and how you go to school kind of a service. And so we've seen the (inaudible) change happen, and we feel like it's a great tailwind for us. And you can tell from the comments, we're really excited about it. So thanks for the question, Sidney.

Operator^ (Operator Instructions) Seeing no further questions, I will now turn the call back to Lucas Haldeman for closing remarks.

Lucas Haldeman^ Thank you. Thank you all for joining the call.

We look forward to speaking with you soon. Take care.

Operator^ This will conclude today's conference call. Thank you for joining us. You may now disconnect.