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SmartRent, Inc.

3Q 2023 Earnings

SmartRent, Inc.

Third Quarter 2023 Earnings

CORPORATE SPEAKERS:

Brian Rutenbur

SmartRent, Inc.; Senior Vice President of Investor Relations

Lucas Haldeman

SmartRent, Inc.; Chairman and CEO

Hiroshi Okamoto

SmartRent, Inc.; Chief Financial Officer

PARTICIPANTS:

Nikhil Vijay

KBW; Assistant Vice President

Erik Woodring

Morgan Stanley; Analyst

Sidney Ho

Deutsche Bank; Analyst

Brett Knoblauch

Cantor Fitzgerald; Analyst

Thomas White

DA Davidson; Analyst

PRESENTATION:

Operator^ Hello. Welcome to SmartRent Inc. Conference Call. Please note that this call is being recorded. I'd now like to hand over to the first speaker for today Brian Rutenbur. Please go ahead.

Brian Rutenbur^ Hello, And thank you for joining us today. My name is Brian Rutenbur, Senior Vice President of Investor Relations for SmartRent. 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 third quarter of 2023 as well as discussing guidance for the fourth quarter of the year.

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

SmartRent, Inc.

Third Quarter 2023 Earnings

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. 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 a third quarter earnings deck is available on the Investor Relations section of our website. With that, let me turn the call over to Lucas to review our results.

Lucas Haldeman^ Good morning. Thank you for joining our call. We reported a strong first nine months of 2023, marked by nearly 40% improvement in revenue and a decrease in our operating losses by more than \$40 million. In the third quarter, we delivered both revenue and adjusted EBITDA within our guidance range.

We grew total revenue by 22% year-over-year to more than \$58 million, and we improved adjusted EBITDA to negative \$5 million, an increase of approximately \$1.5 million sequentially and \$12.6 million from the third quarter of 2022.

This quarter marks our sixth consecutive quarter of improved adjusted EBITDA, primarily driven by higher gross margin. In the third quarter, we increased bookings from second quarter levels by 57% to more than \$49 million.

We also expanded overall gross margin by nearly 5percentage points from the second quarter to more than 23% and from 2.5% last year. Hardware and hosted services gross margin hit record highs. We increased our cash position by \$40 million.

We believe that we will achieve sustainable positive cash flow from operations within six months after reaching profitability on an adjusted EBITDA basis. SmartRent continues to lead in innovation, creating new products that pave the way for the next generation of smarter living and working in rental housing.

SmartRent, Inc.

Third Quarter 2023 Earnings

This quarter, I'm pleased to share that we're launching a product that has been years in the making. We are bringing our [Hub Plus] device to rental housing, the latest best-in-class solution that we have built from the ground up. It's sleek, it's modern, it's smart.

It's the next level of smart technology for our customers and combines the power of our Smart Home hub at a smart thermostat into one single device. It's less hardware to install and offers all the benefits of our other hubs and thermostats. It powers remote capabilities, simplified automation and more efficient operations. It's a product we are proud to bring to market and are encouraged by the positive feedback we're hearing from our customers.

We are beginning to deploy the [Hub+] and anticipate that we will see more meaningful results and revenue contribution in 2024.

We are also moving forward with integrating new artificial intelligence applications into our products. The strategic application of AI is growing in importance for streamlining operations and rental housing.

One example of how SmartRent is introducing AI to our solutions is a new feature in our work management product called [Walk and Talk]. This AI-powered feature enables users to use natural language to describe tasks that need to be completed, like any unit repairs and automatically creates and assigns work orders. [Walk and Talk] saves site teams valuable time, empowering them to easily categorize and complete day-to-day tasks.

SmartRent data shows that when utilizing [Walk and Talk], maintenance technicians can create a work order 70% faster. The efficiencies realized from automating countless tasks result in hours and dollars saved while also contributing to higher team satisfaction.

We continue to lead the industry by innovating new hardware and software solutions for the rental housing market. We are pleased with our results and our strengthening balance sheet.

We remain on track to achieve adjusted EBITDA profitability by the end of the year and cash flow breakeven within the following six months. I will now turn the call over to Hiroshi to review the financials in more detail.

Hiroshi Okamoto^ Thank you, Lucas. Q3 marked a quarter of internal changes in operational improvements to reposition the company for sustainable future profitability and growth. Amidst this backdrop of changes, it was a quarter of solid revenue, expanding margins and narrowing adjusted EBITDA loss.

As Lucas reiterated, we are on track to become adjusted EBITDA positive in Q4. In discussing the highlights for the quarter, I will group my points into the following categories: first, revenue

SmartRent, Inc.

Third Quarter 2023 Earnings

and bookings growth; second, operational improvements and margin expansion; and third, profitability and cash optimization.

Total revenue for the quarter was \$58.1 million, up 9% from Q2 and 22% from Q3 of last year. This was the second highest quarter for revenue in the company's history following Q1 of this year. The first three quarters of the year totaled \$177 million, up 39% from \$127 million for the first three quarters of 2022 and already surpassing our total fiscal 2022 revenue of \$168 million. By revenue stream, hardware revenue was \$35.6 million. Professional services was \$6 million and hosted services was \$16.5 million.

The composition of our revenue continues to evolve as our expanded product line is being adopted by our customers. ARPU for hardware continues on an upward trajectory of 8% year-over-year. Professional services ARPU increased 32% year-over-year. SaaS ARR increased from \$39 million in Q2 to \$43 million in Q3 as we topped \$10 million in quarterly SaaS revenue for the first time. This was an increase of 12% sequentially and a 35% increase year-over-year.

Total deployed units increased to 683,000, with 32,000 units being deployed this quarter. Bookings for the quarter were \$49.7 million and 46,000 units, up 57% and 132%, respectively, from the previous quarter. Although we expect bookings to continue to be nonlinear from quarter-to-quarter, we are encouraged not only by the increases in bookings and booked units this quarter, but by bookings, ARR, ARPU being above \$8 for the second quarter in a row.

This demonstrates how our efforts to cross-sell and upsell the suite of products are starting to flow through to our performance metrics. Operational improvements continued to drive gross margin expansion for hardware and hosted services.

Total gross profit was \$13.5 million compared to \$10 million last quarter and \$1 million a year ago. Hardware margin increased to 23%, up from 21% last quarter and 5% a year ago and in absolute dollars contributed \$8.1 million.

Efficiencies in manufacturing, logistics and distribution continue to drive expanded margins in hardware. Hosted services contributed \$10.6 million of gross profit compared to \$10 million last quarter and \$7 million a year ago. Hosted services margin increased to 64%, up from 63% last quarter and 51% a year ago.

SaaS margins, a part of hosted services, held steady at 74%, an increase from 57% a year ago. Professional services gross margin declined in Q3 due to lower deployment volumes. However I want to highlight that we have continued to invest in technology initiatives over the past several quarters to allow our teams to be more efficient with installations and further our collaboration with trusted partners to augment our teams.

SmartRent, Inc.

Third Quarter 2023 Earnings

The operational improvements we have implemented transforms our professional services to a more variable cost model.

As we evolve the model toward generating a positive margin, we believe that we will have improved professional services margin in Q4 with continued improvement throughout 2024.

Adjusted EBITDA for the quarter was negative \$5 million, an improvement of 22% from Q2 of negative \$6.4 million. Total operating expenses was \$23.5 million, a decrease of 16% from \$27.8 million a year ago and an incremental increase from \$22 million in Q2 as we continue to grow our operations.

The significant changes we made to our operating model in the pursuit of efficiency gains in optimizing processes is what will allow us to scale for long-term growth and profitability. In addition to our focus on operational profitability, getting the business to generate cash has been equally important.

Our cash balance increased to \$211 million from approximately \$197 million at the end of Q2, an increase of about \$14 million.

The increase in cash this quarter is not a result of the ADI arrangement, but is primarily due to improved inventory management and demand forecasting to reduce our inventory levels as we gradually transition to ADI over the next year.

We continue to have no debt, maintain an undrawn credit facility of \$75 million, and we reiterate that we expect to be free cash flow positive from operations in the first half of next year. Guidance for Q4 and full year 2023 are as follows.

We are narrowing Q4 guidance for revenue to \$58 million to \$63 million from \$58 million to \$70 million. We are reiterating adjusted EBITDA to be breakeven to positive \$2 million for the quarter. Accordingly, we are narrowing full year guidance for revenue to \$235 million to \$240 million from \$233 million to \$250 million.

We are narrowing adjusted EBITDA toward the higher end of the range to negative \$20 million to negative \$18 million 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. In the latter half of 2023, we have remained focused on optimizing our operations to become adjusted EBITDA positive. Improvements in gross margin and tight control of operating expenses led to improved profitability, with adjusted EBITDA hitting a quarterly record since becoming a public company.

SmartRent, Inc.

Third Quarter 2023 Earnings

We implemented technology initiatives and further augmented our implementation team with trusted partners to transform our professional services to more of a variable cost model which we believe will improve our professional services margin in Q4 and into 2024.

We have a strong balance sheet and cash position and have clear visibility on cash flow in the near term. We will continue to evaluate our best uses of cash moving forward.

Our IoT solutions are now deployed in more than 680,000 rental units. The total addressable opportunity in rental housing in the U.S. stands at more than 40 million units offering ample room for growth. Each quarter, we penetrate more of the market by anticipating and responding to the needs our customers share with us.

Our customers are generating strong returns from our solutions through enhancing their operations, protecting assets, generating revenues and improving the quality of living and working in their communities. As I shared earlier in our call, innovation is a cornerstone of our approach.

We create, invest in and deploy offerings that add unparalleled value for our clients. It remains important for us to pursue both SaaS and hardware opportunities as our customers demand and benefit from the integration of [Volt Solutions] Our powerful combination of our hardware and software products has allowed us to scale and lead the proptech industry.

The ROI of our platform provides our customers ongoing incentive to roll out our solutions as property owners seek to optimize business operations. From protecting assets with our leak sensor technology, to creating connected communities with community WiFi, to automating workflows and tasks for site teams, our intentionally designed solutions, power a better world and make living and working easier for all. Operator, please open the call for questions.

Operator^ (Operator Instructions) Our first question comes from Nikhil Vijay from KBW.

Nikhil Vijay^ This is Nikhil Vijay on for Ryan Tomasello. I have two for you. First, can you provide more color around what you are seeing in terms of macro and [apartment] and market conditions?

Just curious how have customer conversations and overall demand being trending in light of the headwinds that the apartment operators been facing. Secondly, have you seen any changes in the M&A landscape in terms of the deal flow and valuations? And is that something you would still consider at the right price and strategic (inaudible)?

Lucas Haldeman^ Thanks, Nikhil. I'll take both of those. First, on the macro environment, I think we're definitely seeing a softening rent environment.

SmartRent, Inc.

Third Quarter 2023 Earnings

We saw that from the latest public reports. It actually continues to be a tailwind for us as owners and managers are really focused on reducing expenses and driving ancillary revenue, something that our platform does both of those things.

And so while we are seeing some softening in the market around rents, it's not hurting our demand at all. Then in terms of changes in the M&A environment, we continue to look as things come to market.

We have not seen anything that we believe is an opportunity we should pursue at the moment, but always looking, and I think certainly, as you see us move from adjusted EBITDA positive to free cash flow, I think that will open up some of the cash on the balance sheet to look at those opportunities.

So nothing to guide you to, Nikhil, but feeling good about where the market is. I do think we're starting to see private company valuations come into line. Thanks for the question.

Operator^ Our next question comes from Erik Woodring from Morgan Stanley.

Erik Woodring^ I'm going to try to sneak in three, if I can. The first one maybe for you, Lucas, is just kind of bigger picture. Your unit deployments have trended lower in the last two quarters. I know that you are trying to kind of balance profitability and growth, but with you guiding down full year revenue slightly this quarter, it's a little hard to parse out, what of this, kind of deployment slowdown is maybe intentional versus a product of the environment and demand from your customers. So is there any additional color that you can share with us?

So just kind of help us gain comfort in the longevity of the different headwinds you're seeing to deployments, especially about when we think about deployments maybe getting back to growth. What we need to see to unlock that growth lever? Just a little more color would be very helpful.

Lucas Haldeman^ Sure. Thanks for the question, Erik. I think last year at this time, I think it was the quarterly call this year, we really tried to signal to investors and to the analyst community that we're diverging from the primary KPI of this business being new units and that we're really focused on growing revenue, but more importantly, getting to profitability and so that means growing profitable revenue.

So what you've seen is we're -- that is the focus. We're focused on where is the ability to grow profitable revenue. It's not just about achieving top line results. So where I kind of guide you to, Erik, is -- it really -- we are looking to go to the higher end range of the adjusted EBITDA positive and what that means is slightly less total revenue.

But ultimately, what we feel like and what we've heard from the investment community is that getting that profitability and maintaining that is more important than achieving top line results.

SmartRent, Inc.

Third Quarter 2023 Earnings

So I think what you're seeing in terms of new unit deployment is completely intentional as we're really working to get to free cash flow positive.

Erik Woodring^ Okay. Very clear. Then maybe my second question is for Hiroshi, but it's obviously great to see and to reiterate what you just said, Lucas, to see you guys expecting to reach EBITDA profitability in 4Q. I think the revenue guide implies a fairly similar level of revenue in 4Q to 3Q. But obviously we need to see some improvement in the PS gross margins to reach EBITDA profitability.

I think fairly sizable tick up in PS gross margins. Can you just make sure help us understand how we should think about professional services gross margins in 4Q? And really, what are the tools or the levers that will help you improve that margin profile in really this three months? That would be helpful for us.

Hiroshi Okamoto^ Thanks, Erik. I think in terms of the -- trying to get to adjusted EBITDA profitable in Q4, you hit it right on the nose is, we have to improve our pro services margins. We know that we've been doing this for the last quarters, improving adjusted EBITDA. So we really understand the levers that we need to pull to get there now.

In terms of [post] professional services, what it is, is that the variability of the margins really depends on the deployment volume still.

But we've made -- we've developed some technologies, made some operational improvements to move that more to a variable cost basis. One example of that is being able to monitor progress of our projects, not being on site but doing it remotely.

So it's things like this that we have implemented really towards the end of Q3 where we'll see improvements in Q4. That's what gives us the comfort that we could get there.

Erik Woodring^ Okay. Very clear. Then maybe my last question is just -- it looks like hardware revenue per new unit deployed in 3Q is up pretty tremendously both year-over-year and quarter-over-quarter. First, I just want to make sure I'm thinking about that correctly.

And second, just -- I just want to better understand kind of the underlying drivers of what's driving that strong hardware pricing because it does assume or it does imply that hardware pricing and new deployments effectively doubled in the last three months. So just trying to get to the underlying factors driving that.

Hiroshi Okamoto^ Yes. I think the underlying factor is that we are selling more products for customers that we're selling to. And examples of that would be the Alloy Access and [self-guided tour] of some of the products that we are selling in terms of cross-sell.

SmartRent, Inc.

Third Quarter 2023 Earnings

Lucas Haldeman^ Erik, I'll just add a little color to that as well. I think what we're seeing this year is also a byproduct of not being supply constrained with Alloy Access.

So a lot of our new deployments -- and for a while our customers [deployments] are both IoT hardware and common area access control hardware. You're also seeing a little bit of Wi-Fi hardware coming in there.

So some of what's driving it, it's not so much that, hey, the sort of same-store IoT hardware is dramatically different, but it's more hardware because of more products being adopted by our customer set.

Erik Woodring^ Okay. Very clear. Congrats on the good quarter, guys.

Lucas Haldeman^ Great. Thanks, Erik.

Operator^ Our next question comes from Sidney Ho.

Sidney Ho^ I have a follow-up question to the prior question on the gross margin for Professional Services. You talked about that improving in Q4 based on the actions you are taking. Can you give us a sense where gross margin could be in Q4, particularly?

But also at what revenue level should we think about that business being breakeven from a gross margin perspective?

Lucas Haldeman^ Hi, Sidney, thanks for the question. I'll give an answer, and Hiroshi can add some color if he has anything else to say. I mean I think what -- what we said in some of the prepared remarks, and I'll just kind of reiterate is really this was -- Q3 was sort of a culmination of a lot of internal development of technology to improve how we deploy resources as well as a transformation of how we actually go about doing the install.

And so as you've seen sort of a stair-step function, I feel like this is coming into Q4 is the first quarter where you're not going to see that sort of stair step. It's a -- we've deployed a new strategy that's materially different.

And the whole idea around this, Sidney, is that we can achieve breakeven or slightly positive margins on professional services regardless of the volume of installs that we're doing.

And so it's a transformation driven by technology of moving from really a heavy fixed cost installation model to a much more variable cost model so that we don't have to think about it in the same ways, like to your question, we think about it as I have to achieve x to hit breakeven. That really that can move as the pace of install moves up and down.

SmartRent, Inc.

Third Quarter 2023 Earnings

Hiroshi Okamoto^ Yes. I think just to add to that. Sorry, we're not providing guidance on our gross margins, but I think you could see a significant improvement in Q4. We hope to get that positive sometime in 2024, professional services I'm talking about.

Sidney Ho^ Got it. I got it. That's very clear. My follow-up question is, it's great to see that your booking units improved a lot this quarter. I think last quarter, you talked about some customers not willing to put in new orders until the existing orders are fulfilled.

How have those conversations changed to drive that unit kind of booking unit growth that you saw? And along the same line, I noticed that booking dollars didn't grow as much as units. Can you talk about that dynamic as well?

Lucas Haldeman^ Yes. I think we feel like we had a good quarter of bookings. And just to reiterate, bookings will be lumpy. It moves around, if not a linear function, and it's not really driver or indicator of our demand. There's a lot of different things at play depending on the customer.

But I think what drove the strong bookings quarter -- this quarter, in Q3, was really around we did wrap up a fair number of customers' projects and took new orders as well as we had a good quarter of selling to new customers, getting some new customers on board.

Sidney Ho^ Maybe if I just squeeze in one more. Understanding it's too early to give guidance for next year, but considering the several changes in strategy that you guys are going through this year, conceptually, how should we think about what's driving revenue growth next year?

Maybe revenue is not the focus, like you mentioned earlier, Lucas. Is it more unit deployment? Is it higher hardware ARPU or mainly on software SaaS? Maybe broadly speaking, what are the top priorities for the management team?

Lucas Haldeman^ Well I think the priorities continue to remain. We've said within six months will be free cash flow positive next year. So the priority remains achieving that which is really about driving our most profitable revenue.

So internally, we don't think myopically about new units but really around where our levers to drive growth. And cross-sell and upsell continues to be a successful area where we're able to sell additional products to new customers.

Then I think it really -- as you've seen, and we did a press release, we've added another new product that we're selling the package rooms, smart package room.

So when you start looking across the landscape and say we have a large number of customers

SmartRent, Inc.

Third Quarter 2023 Earnings

who have deployed IoT only, now we can offer access control, Wi-Fi, smart package rooms, work order management, property operations, software that really optimizing that with our customers. At the same time, we're driving new growth is a recipe for profitability.

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

Brett Knoblauch^ Maybe if we look at SaaS ARPU, it was a nice kind of sequential growth there. Could you maybe go into the drivers behind that? More specifically into your existing deployment base. What new products were they taking up in the quarter?

Have you been more focused on kind of upselling then? Obviously relative to the new units deployed. So I'm curious to what products you're seeing really drive the improvement in SaaS ARPU.

Lucas Haldeman^ Brett, yes, thanks for the question. So I think -- and I think it's a good question. I think we're seeing a lot of customers adding additional products, Access Control and self-guided tour are the two that come to mind as really a package, IoT Access Control and [self-guided tour].

That helps owners unlock savings and efficiencies in labor and really with the macro backdrop that I took in the first question from Nikhil, that's become a real focus.

So we're having a lot of success saying, hey, to be able to save on labor costs, these three products work in harmony together. You're seeing that come out in the ARPU. All three of those help drive ARPU growth.

Brett Knoblauch^ Perfect. Then maybe a question for Hiroshi on professional services. Obviously with the changes you're making in that segment revenue decline this quarter. How should we think directionally about professional services revenue in the fourth quarter and maybe as we look at 2024. Should we expect that revenue to be down next year?

Hiroshi Okamoto^ I think in terms of revenues for professional services for Q4 would probably be similar to Q3. And Q4 2024, we haven't given guidance yet, but we think it will be slightly up.

Lucas Haldeman^ Yes. I think just -- I'd like to just point you, Brett, towards really -- professional services will vary based on new unit deployment, and that it's sort of is what it is.

The way we feel internally is once that's breakeven or slightly positive, it's less of a focus overall on the company, and that's where you'll see -- we have intentionally said we're not going to grow units -- as new units as quickly as we have in the past because we are focusing on cross-sell, upsell profitability. So it's less of an internal barometer than it once was for us.

SmartRent, Inc.

Third Quarter 2023 Earnings

Operator^ Our next question comes from Tom White from DA Davidson.

Thomas White^ I'm not sure if I heard an update on WiFi in the prepared remarks. I realize it's still early, and it's going to be longer in sales segment. But just curious how you guys see traction there?

Then just secondarily on the new integrated hub, I miss that. Can you just maybe talk a little bit more about sort of how that might impact the financial model over the coming quarters?

Is it a revenue opportunity? Is it about unlocking additional efficiencies for customers in that kind of (inaudible)?

Lucas Haldeman^ Yes, update on WiFi, again we think that WiFi really becomes a driver of significant revenue in 2025, but we remain really enthusiastic about the demand we're seeing for that product.

We have a tremendous number of quotes that we've been generating active jobs that we're working and still feel like that's going to be a very important piece of our platform going forward.

We were just -- actually one of our NMHC National Multi-Housing Council shows -- and I was with a lot of customers, and it's top of everyone's mind, not just our WiFi product, but WiFi in general.

So I know it's an exciting time for this industry, and I think we're going to capitalize on that. In terms of the new alloy [Hub Plus] the new integrated hub, there's not a material difference in top line revenue.

But there'll be a pickup in gross margin because instead of installing a third-party thermostat where we're a distributor of hardware that -- the hub is something we're making.

So the thermostat, if you think about the margin on that will be higher. So we see gross margin pick up in hardware from installing the hub plus.

And more importantly, I think it really is a combination of years of R&D that we've been working on to build this from the ground up, bring it to market. There's a lot of strategic importance around it, just around connectivity and where it's placed and less hardware and less time to install and I'm very excited by that.

Hiroshi Okamoto^ Yes. Just to add to that, I think we're introducing it right now. We won't see a meaningful improvement in gross margin in Q4, but really a driver for 2024.

SmartRent, Inc.

Third Quarter 2023 Earnings

Operator^ Looks like we don't have any incoming questions as of right now. I'd now like to hand back over to the management for their final remarks.

Lucas Haldeman^ Thank you, Operator. Thank you, all for joining. I appreciate your support and taking time to listen and look forward to speaking with you all soon. Have a great day.

Operator^ Thank you for everyone joining in today's session. We hope you found it useful. Have a wonderful day and stay safe.