

**Holley**  
**Third Quarter 2022 Earnings Call**  
**November 14, 2022**

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**Presenters**

**Tom Tomlinson, President and CEO**

**Steve Trussell, Vice President of Finance**

**Vinny Nimmagadda, Executive Vice President of Corporate Development and New Ventures**

**Q&A Participants**

**Joe Altobello – Raymond James**

**Ryan Sundby – William Blair**

**Christian Carlino – JPMorgan**

**Alex Perry – Bank of America**

**Joe Feldman – Telsey Advisory Group**

**Operator**

Good afternoon. And welcome to the Holley third quarter 2022 earnings call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation.

If anyone should require operator assistance during the conference, please press star zero on your telephone keypad. Please note, this conference is being recorded.

I will now turn the conference over to our host, Ross Collins, with investor relations. Thank you. You may begin.

**Ross Collins**

Thank you, Diego. Good morning, everyone. Thank you for taking the time to join us today.

On the call with me today are Tom Tomlinson, president and chief executive officer; Steve Trussell, vice president of finance and internal finance--chief finance officer; Vinny Nimmagadda, executive vice president of corporate development and new ventures. After their prepared remarks, we will open the call for questions.

Now, I will reference the safe provisions under the Private Securities Litigation Reform Act of 1995. This call may contain certain forward-looking statements that are subject to significant risks and uncertainties, including the future operating and financial performance of the company. In many cases, these risks and uncertainties are beyond the company's control.

Although the company believes the expectations reflected in its forward-looking statements are reasonable, they can give no assurance that such expectations or any of its forward-looking statements will prove to be correct. And actual results may differ materially from expectations.

Important risk factors that could cause actual results to differ materially from those reflected in the forward-looking statements are included in the company's recent 10-Q, S-4, and S-1 filings with the Securities and Exchange Commission. The information contained in this call is accurate only as of the date discussed. Investors should not assume the statements will remain relative and operative at a later time. Holley undertakes no obligation to update any information discussed in this call in the future.

Additionally, we will be discussing certain non-GAAP financial measures. A reconciliation of these items to U.S. GAAP are included in today's press release, which is also posted on our investor relations website.

At this time, I would like to turn the call over Tom Tomlinson, Holley's chief executive officer. Tom?

**Tom Tomlinson**

Thanks, Ross. Good afternoon, everyone. And thanks for joining us today.

As part of the call today, we'll be referring to a slide deck titled third quarter 2022 supplemental earnings information. This deck is available for download on our IR website, [investor.holley.com](http://investor.holley.com).

As we stated in our press release this afternoon, while we're encouraged by the sequential improvement we saw during the quarter, our earnings fell short of expectations. After decreasing further in July, sales improved in August and September as we began to overcome supply chain related challenges.

Although sales for the quarter were down year over year, our shipment rates progressively improved within the quarter and sales in September were above prior year as highlighted on slide three. Supply chain constraints peaked in July and then began to ease. Increased receipts of components from global suppliers allowed us to steadily produce and ship more product in August and September. These improving run rates in Q3 are illustrated on slide four.

Our suppliers of certain automotive grade microchips also began to resume shipments during the quarter, which allowed us to progressively build and ship more of our popular electronic products. These suppliers have also provided improved visibility to future shipments. As discussed last quarter, we acquired a large quantity of automotive grade microchips on the spot market that were unusable upon initially receiving them. We've now developed and validated a process to reprogram those chips, restoring them to full functionality and enabling us to begin consuming them in production.

While challenges remain in the supply chain, we're focused on improving availability of components and increasing shipments.

Profitability was negatively impacted by lower production volumes that drove negative operating leverage and manufacturing inefficiencies, especially earlier in the quarter. We also saw higher input costs from both inflationary pressures as well as scarcity related cost escalation in connection with automotive grade microchips.

Warranty costs were higher as resellers caught up on backlog of warranty returns. And higher inbound freight and other overhead costs are continuing to work their way through inventory. Pricing actions taken midyear partially offset these costs headwinds.

As sales increased in August and September, we saw operating leverage turn positive, resulting in progressively improving earnings, although still below historical levels as a result of the aforementioned cost headwinds.

Channel inventory decreased by \$8.4 million in the quarter, although stronger shipments to resellers in September allowed us to begin rebuilding channel inventory, partially offsetting the decreases that occurred in July and August. These monthly channel inventory changes are set forth on slide five.

Underlying demand has remained solid despite our supply chain challenges. Past due orders represent demand that we have not yet been able to convert to sales by shipping against orders placed by consumers and resellers. Past due orders have remained elevated throughout the year.

As shown on slide six, our steadily improving sales run rates in August and September allowed us to reduce excess past due orders by \$11.1 million in the quarter. At the end of the quarter, excess past dues remained elevated and were \$30.6 million. We're looking forward to eliminating excess past due orders as supply chain conditions continue to improve.

We're pleased with the solid demand we've seen for our products at a time when consumers are stressed by inflationary pressures. Our direct-to-consumer sales were up 11 percent and we saw enthusiast engagement continue to accelerate at our Holley-owned events. As highlighted on slide two, DTC sales were up year over year despite supply chain challenges that left us out of stock on many of our popular products. DTC sales provide us with visibility into consumer behavior and insight into underlying consumer demand because DTC sales are not influenced by reseller purchasing decisions.

Our DTC strategy is core to what we do. And the growth in our DTC channel continues to be driven by innovation, strong performance marketing, content and social media engagement,

event expansions, and new brand integrations. Growing DTC sales remains a priority for our team.

With the improvements we realized within the quarter, we believe we're now better positioned to convert more of the demand we've seen into sales as supply chain conditions continue to improve and as we continue to execute operationally. There is a lot more work to do to lower our costs and reduce our inventory levels, and we see numerous other opportunities for further operational improvements.

Our team is aggressively pursuing strategies to drive higher productivity and lower our cost structure. And we're continuing to make progress integrating acquired businesses in order to drive further synergies.

With so much work to do, we're pleased to announce the appointment of Brian Applegate as interim chief operating officer. Brian, who has advised Holley on M&A since 2018, is a performance aftermarket industry veteran with a wealth of operating experience. He's a known quantity to our team and we're excited to partner with Brian to drive near term improvement in our operating performance.

As interim COO, he will be focused on our highest priorities and largest near-term opportunities in supply chain, manufacturing, and engineering. Brian's efforts in these areas will help accelerate our improvement initiatives and allow us to realize the benefits of these improvements more quickly.

We remain confident in the underlying profitability and cash flow generation potential of our business. And we firmly believe that Holley's position as an industry leader with ample runway for long-term profitable growth is unchanged.

I'll now turn it over to Vinny to discuss recent M&A activity and consumer engagement. Vinny?

**Vinny Nimmagadda**

Thank you, Tom. And good afternoon to everyone on the call.

Though we did not complete an acquisition during the third quarter, we are progressing on integration. As we had said on prior calls, driving synergies from our past acquisitions enables Holley to continue to maximize value creation within the year. As we realize these savings on an annualized basis, we will enhance our balance sheet strength and further improve our liquidity position in support of long-term growth.

As a reminder, over the past 12 months, we have completed five acquisitions that were highly strategic and expanded our wide range of products. During the quarter, we further integrated several of our acquired companies onto our internal ERP system, reducing overall costs and increasing operational efficiencies.

Just to provide an example, we closed on RaceQuip in late June, and I am proud to report the team's success in completing our integration in early September. To that end, RaceQuip's safety products are now seamlessly offered to resellers alongside our existing performance and safety offering. And for the first time, sold direct to consumers through holley.com and our existing digital platform.

I would now like to shift to our Holley owned consumer events as we have just completed a very productive event season highlighted by positive consumer engagement. During the quarter, Holley hosted its 13th annual LS Fest east event in our hometown of Bowling Green, Kentucky, as well as Holley MoParty and Holley's Intergalactic Ford Festival. In total, our 2022 event attendance is up 12 percent from the prior year's events.

The growth in popularity of Holley's company owned events allows our team the opportunity to make an emotional connection with our enthusiast community, learn more about our consumers, and further bolster our idea bank for new products. In addition, our events hosted in the--in Bowling Green continue to make a positive local impact in our community.

Last, we are continuing to leverage content marketing as a way to engage, inspire, and support our enthusiast customers. During our fall 2022 event season, Holley experienced a 52 percent increase in social engagement and our social media platforms experienced 6.4 million video views.

With that overview, I'd now like to hand the call over to Steve, who will discuss our third quarter financial results in greater detail. Steve?

**Steve Trussell**

Thank you, Vinny. And good afternoon, everyone. Holley delivered net sales of \$154.8 million in the third quarter, a 3.1 percent decrease from \$159.7 million in the third quarter of 2021.

Non-comparable sales associated with acquisitions contributed \$7.7 million, or 4.8 percent of year over year growth. The remaining comparable sales decreased by \$12.6 million, or 7.9 percent compared to the prior year quarter, offsetting the impact from the acquisitions.

As we have stated in the past, we typically don't disclose monthly pacing of results, but we believe it is important to illustrate how sales trends improved as the quarter progressed.

We had lower sales early in the quarter, with July seeing the worst of the impact. We began to see improvements late in August, and we saw meaningful turnaround in sales performance in September as sales grew 31 percent year over year. The headwinds that Tom discussed were the main reason for the weakness in July and August sales. Although, as the quarter progressed, we saw shipments improved.

Gross profit for the third quarter of 2022 decreased \$16.8 million, or 25.8 percent to \$48.4 million when compared to \$65.2 million for the third quarter of 2021. Gross margin for the third quarter of 2022 was 31.3 percent compared to a gross margin of 40.8 percent for the third quarter of 2021.

Of the 960-basis point decrease in gross profit, 510 basis points were driven by inflationary pressures and 290 basis points gained from higher expenses associated with warranty costs. The remaining decrease came from loss leverage due to the lower sales volume.

Total selling, general, and administrative expenses increased by \$3 million, or 10.5 percent in the third quarter. The increase in SG&A was driven by a 2.6 million increase in outbound shipping and handling costs related to inflationary pressures from domestic shipping companies and an increase of a million dollars attributable to recent acquisitions.

Partially offsetting these increases was a decrease of 1.6 million in administrative and sales personnel costs reflecting the company's implementation of recent cost saving initiatives. Interest expense increased by 5.9 percent from the third quarter of 2021 to 10.4 million, reflecting a higher level of debt and a higher effective interest rate.

We recorded net income of \$31.6 million in the third quarter of 2022. Net income for the third quarter of 2022 was favorably impacted by a \$37.6 million non-cash decrease in liabilities for warrants and our announced shares. On an adjusted basis, net loss was \$4.1 million versus net income of \$4.6 million from the third quarter of 2021.

Adjusted EBITDA decreased to \$16.4 million in the third quarter, down from \$35.5 million in the third quarter of 2021. The issues we have discussed, which include supply chain challenges that disrupted sales and caused operational inefficiencies, elevated warranty expense, and higher shipping expenses were the core headwinds to our EBITDA performance during the quarter.

Turning to our balance sheet. We have seen a significant increase in inventory during 2022. Inventory increased by 45 million from the end of 2021 to the end of the third quarter of 2022. The largest factor in this increase is the higher cost of the items in inventory from inflation and higher freight costs. In addition, as the supply chain became more unreliable, we are holding additional safety stock and components for product we cannot yet ship.

We are focused on improving financial performance and working capital management towards the goal of healthy cash generation.

We have maintained ample liquidity as we ended the quarter with 16.6 million in cash and have the full capacity of our undrawn revolver. Additionally, our leverage ratio remains below the level where restrictive covenants apply, and we fully expect that to hold true through our current outlook. A summary of our liquidity profile can be found on slide seven of the investor deck.

Moving to our outlook for 2022. As you saw in our press release, we are updating our guidance, which now calls for annual net sales in the range of 695 million to \$710 million and adjusted EBITDA between 118 million and \$124 million. We also adjusted our capex expectations to be in the range of 14 to 15 million, while we are maintaining our depreciation and amortization and interest expense guidance which are between 24 to \$26 million and 33 to \$35 million respectively. This guidance includes reduced spending to reflect the challenging environment in the months ahead and takes our leverage ratio into consideration.

That concludes our prepared remarks. And I'll now turn the call over to Ross so we can address your questions.

**Operator**

Thank you. And at this time, we'll be conducting a--.

**Ross Collins**

--Absolutely, Steve. As a reminder, we ask that you please limit yourself to one question and one related follow up as needed. Diego, please open the line for questions from our participants.

**Operator**

Thank you. And at this time, we'll conduct our question-and-answer session. If you would like to ask a question, please press star one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star two if you would like to remove your question from the queue.

For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star key.

Our first question comes from Joe Altobello with Raymond James. Please state your question.

**Joe Altobello**

Thanks. Hey, guys. Good afternoon.

I guess the first question, I wanted to follow up on the commentary regarding September. It looked trends did improve in the month. And I look at your guidance and--at least your sales guidance assumes a further decline in sales in the fourth quarter. It looks like it worsens a little bit from Q3.

So, I'm curious, I guess, how October and first half of November look. Do you see continued improvement? And do you think those issues that you saw on the supply chain side are going to continue throughout 2023? Or could we see them continue to get better next year?

**Tom Tomlinson**

So, from the standpoint of the question around supply chain, I would say that while we made improvements--saw improvements on the supply chain, there continue to be risks around supply chain. One of the specific areas of risk I would mention is just in the availability of microchips. And while we have seen that improve, when we talk to the manufacturers and distributors of those microchips, there is still scarcity.

And when we talk about the fact that our receipts of microchips have improved, those--the specific microchip we're talking about there is one that is used in our largest electronic product line that uses those types of chips.

The second largest category--or product category or product line is where we are still seeing constrained chips and there is risk that we receive less chips in the remainder of the year than we did in the second and third quarter.

And so, obviously, this category has a large overall impact on our sales. And so, we're looking at the risks as well as the opportunities as we set our guidance going forward.

**Joe Altobello**

Okay. So, just to be clear, it doesn't sound like you're seeing anything getting worse in October and November. But it sounds like you're just trying to lay out a more conservative outlook at this point.

**Tom Tomlinson**

Yes. We think that's fair.

**Joe Altobello**

Okay. Okay. Thank you, guys.

**Operator**

Our next question comes from Ryan Sundby with William Blair. Please state your question.

**Ryan Sundby**

Yeah. Hey, guys. Thanks for the questions.

Wanted to ask a little bit more on the warranty costs. Was that a onetime hit this quarter? Or should we expect to see that continue to happen moving forward?

**Tom Tomlinson**

So, we believe there was a backlog of warranty claims or warranty returns that were sitting at our resellers, and a lot of those came in in the quarter. We have provided for an increase in warranty throughout the remainder of the year to ensure that our--that was our effort to make provisions for any additional warranty that would come in.

**Ryan Sundby**

Okay. Got it. And then, thanks for all the projection that you provided in the slides here.

I guess, digging in on the reseller destocking, we did start to see that improve in September. Could you talk a little bit more about where inventory levels sit today, how comfortable are you with them, and should we expect to see more refill taking place in Q4? Or is that cut off now?

**Tom Tomlinson**

When you--so, we don't have perfect visibility to channel inventories, but we're able to track the increases and decreases and channel inventories with our largest resellers. And basically, when--in this environment, when you see channel inventory go down, specifically in July and August, that is primarily driven by our inability to ship our excess past due orders.

And as we saw our ability to ship improve in September, there was an immediate improvement in terms of the channel inventory.

So, we're certainly working hard to drive continued improvement from a supply chain standpoint, from a manufacturing operations standpoint so we can get more throughput and ship more product. And at this point, we believe that that will allow us to improve the channel inventory position.

**Ryan Sundby**

Got it. Great. Thanks. I'll jump back in the queue.

**Operator**

Our next question comes from Christian Carlino with JPMorgan. Please go ahead.

**Christian Carlino**

Hey. Good evening, guys. Thanks for taking my question.

So, I know you're not guiding to '23, but you've had a few events recently as well as the industry trade show. So, I guess, could you give us an update on some of the learnings you're hearing going on in the industry? What are your peers saying? And can you speak to any level of promotionality or softness, at least for your peers or the industry more broadly?

**Tom Tomlinson**

So, I think one of the things that would be good to talk about here is the discussions that we have with many of our resellers. And they have indicated to us that our competitors are also struggling with supply chain issues. And they've indicated that our performance is at the top of the performance that they're seeing from our--among us and our competitors.

So, we continue to see demand that is solid. You saw that our DTC sales continue to grow. And again, that's against a backdrop of just being out of stock on so many of our most popular items. And when you don't have them in stock, most consumers don't buy them. And so, that represents a missed opportunity there.

I think there's a lot of optimism. This industry has historically grown year over year over year. And we're just looking forward to being able to take advantage of that by improving our shipping performance.

**Christian Carlino**

Got you. That's all really helpful color.

And then, I guess, on some of the cost cutting measures, most of the margin decline is from just fixed cost you leverage. But I guess, do you have to get back to the prior trend of sales to return to mid-20s EBITDA margin? Or are there other areas of self help that you haven't implemented yet, but you have visibility to?

**Tom Tomlinson**

We have visibility to opportunities. And we have some extra help now with Brian Applegate coming on board as our interim COO. So, that gives us more bandwidth to go after these. And so, that very much is going to be our focus and that'll allow us to drive sales higher. As we improve our operations and then as we--you get the leverage associated with the higher sales.

And then as we reduce various costs we talked about, obviously, that'll further enhance profitability.

**Christian Carlino**

Got you. So, you're not cutting into the meat of the business. You're right sizing your operations and you'll benefit from the leverage on the other side of this as well.

**Tom Tomlinson**

That's correct. And one of the things to think about is that we have a number of recent acquisitions. There's more work to do there in terms of integrations and capturing synergies. And that's just an ongoing effort within the company to see those costs come out, and that'll improve our position from a fixed cost standpoint.

**Operator**

Thank you. Our next question comes from Alex Perry with Bank of America. Please go ahead.

**Alex Perry**

Hi. Thanks for taking my questions.

Just first. On slide three, which I think shows sale end, can you maybe help us think about the sequential point of sale trends that retell in the quarter? I think you said resell or destocking continued in July and August before recovering--you're showing shipments in September. But does that imply that the point-of-sale trends didn't change given it just sort of led to rebuilding up inventory? Or did you also see the point-of-sale trends improve in the retailers that you have this built into? Thank you.

**Tom Tomlinson**

So, the visibility that we have is around our products and we--because of our inability to ship the sale through--the out the door sales have been below what they could've otherwise been if we were shipping. As we've seen shipping--our shipping rates improved, we have seen the sell through, and we have seen resellers now start to report increases--year over year increases in their out the door sales.

**Alex Perry**

That's really helpful. And then my follow up question was on gross margins. So, how should we think about 4Q gross margins here? Should we expect a similar level of compression as we saw in the third quarter? What would be the puts and takes here if we're looking at trying to model out 4Q gross margins? Thanks.

**Tom Tomlinson**

Yes, you should expect to see similar type compression in the fourth quarter as some of the factors that hit us in the third quarter are going to continue, higher freight cost, continued inflationary pressures on our component costs.

**Alex Perry**

Perfect. That's really helpful. Best of luck moving forward.

**Tom Tomlinson**

Thank you.

**Operator**

Thank you. Just a reminder, to ask a question, press star one on your telephone keypad. Our next question comes from Joe Feldman with Telsey Advisory Group. Please state your question.

**Joe Feldman**

Yeah. Hey, guys. Good afternoon.

I actually want to follow up on that last question, too. Should we think about a new level of gross margin going forward? Is there any reason you shouldn't get back to the historical percent that you normally have? Are we going to see this kind of pressure for the next few quarters into '23 as well?

**Tom Tomlinson**

It's our intent to restore margins to historical levels. So, we see an opportunity to do that. And there's a lot of work to do, I think, to do that. But the team is very committed to making that happen.

**Joe Feldman**

Okay. Got it. Thanks.

And then just thinking, with respect to inflation, I know you called it out on the cost side, but I'm just wondering, how much inflation is baked into--on this price at this point at retail? Has that been much of an impact on driving sales?

**Tom Tomlinson**

So, it is--it has been pretty significant in terms of over the last two or three years. We have adjusted--typically, we make price adjustments once a year about midyear and last year, in particular, we did three.

We did our increase this year in the mid-June time frame, and that increase was about mid, single digits. So, we're able to get price. We're also mindful that our consumers are stressed. So, we've been careful not to push that lever--or pull that lever too hard.

**Joe Feldman**

Got it. Thanks, guys. Good luck with this quarter. Thank you.

**Tom Tomlinson**

Thank you.

**Operator**

Thank you. There are no further questions at this time. I'll turn the floor back to Tom Tomlinson for closing remarks. Thank you.

**Tom Tomlinson**

Thank you, Diego. Demand has remained solid throughout the quarter, demonstrating the resilience of our enthusiast consumers. As supply chain pressures eased during the quarter, we saw sequential improvement in our production levels which in turn drove higher sales and earnings.

We're intently focused on driving further improvement in these areas in the coming months and fully committed to the aggressive pursuit of near-term opportunities to streamline our cost structure.

We remain confident in the underlying profitability and cash flow generation potential of our business. And as an industry leader, we firmly believe Holley is positioned to capitalize on the long-term favorable demand trends in the performance automotive aftermarket.

This concludes our remarks for the day. Thank you for joining us. And we'll now end the call. Goodbye, everyone.

**Operator**

Thank you. All parties may now disconnect. Have a great evening.