

**Holley, Inc.**  
**Third Quarter 2023 Earnings Conference Call**  
**November 8, 2023**

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**Presenters**

**Ross Collins – IR**

**Matt Stevenson – President, CEO**

**Jesse Weaver – CFO**

**Q&A Participants**

**Brian McNamara – Canaccord Genuity**

**Martin Mitela – Raymond James**

**John Lawrence – Benchmark**

**Sabrina Curran – William Blair**

**Christian Carlino – JPMorgan**

**Joe Feldman – Telsey Advisory**

**Michael Davidson – D.A. Davidson**

**Operator**

Greetings. Welcome to the Holley third quarter 2023 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 “\*” “0” on your telephone keypad. Please note this conference is being recorded.

I will now turn the conference over to your host, Ross Collins, Investor Relations. You may begin.

**Ross Collins**

Thank you, operator. Good morning, and welcome to Holley's third quarter 2023 earnings conference call. On the call with me today are President and Chief Executive Officer, Matt Stevenson and Chief Financial Officer, Jesse Weaver.

This webcast and the presentation materials including non-GAAP reconciliations are available on our Investor Relations website. From time-to-time we post new information that may be of interest or material to investors on this website.

Our discussion today includes forward looking statements that are based on our best view of the world and of our business as we see them today and are subject to risks and uncertainties including the ones described in our SEC filings. This morning, we will review our financial results for the third quarter and share our guidance for the full year 2023. As always, we'll leave time for your questions at the end.

And with that, I'll turn the call over to our CEO, Matt Stevenson.

### **Matthew Stevenson**

Thank you Ross and good morning, everyone. This is now my fifth month at Holley and I continue to remain extremely impressed by the team and the incredible opportunity that exists with this great company. Not only there are tremendous prospects for growth, but we're also finding ways to be more efficient while we're also enhancing our service levels to both consumers and distributors. We are undergoing a comprehensive transformation of the company to unlock all these opportunities and prepare our organization for extensive growth.

During this call, I will highlight some of the transformation that is underway including a new organizational structure on focused on becoming even more consumer centric, the development of a robust product development cycle, increasing the engagement levels with all our customers, including our great distribution partners, lowering our cost to serve by taking a holistic look at our operations and adding new leadership talent to the team. Plus while we are transforming the company for the long term, we are also continuing to deliver in the short term through strong alignment of internal resources and an intense daily focus on meeting our commitments. All of this hard work continued to pay off as we delivered a solid third quarter.

Now let's take a look at some of the highlights from the quarter. On Slide 5 we've highlighted the key takeaways. Due to seasonality, the third quarter is historically our lowest for order demand. But even under those circumstances, we continued to build a path toward our goal of gross margins of approximately 40% in EBITDA margin of greater than 20%. Year-over-year for the third quarter, we dramatically improved gross margins by 600 basis points and increased EBITDA margins by 840 basis points. We also continue the progress of bringing down inventory and pass dues through forecasting and operational improvements, which has enabled us to improve our free cash flow and further pay down our debt.

The summer is always an exciting time for us regarding consumer engagement and it is the peak of our event season and we had four amazing events in the third quarter that continue to show year-over-year increases in attendance. As part of our transformation, we also rolled out a new organizational structure focused on unlocking growth in our consumer verticals and empowering our leaders in our product categories and brands. We'll dive into this in more detail in a few slides. On Slide 6 you can see some of the financial and ongoing business highlights from our third quarter. Net sales were \$156 million, up 1% year-over-year for the quarter. Gross margins and EBITDA margins were both up significantly from the prior year. Gross margins were 37.3% and EBITDA margins were 19% as our lower fixed cost base and numerous operational improvements elevated the bottom-line year-over-year.

Free cash flow was \$21.7 million for the quarter, a \$32 million improvement versus the prior year. This improvement was driven by solid operational performance and meaningful reductions in past dues and inventory.

Now on to some of the business highlights for the quarter. We continued our leadership in product innovation, introducing over 65 new products in the third quarter, including a new plug and play adapter kit for Sniper 1 owners to upgrade to Sniper 2. As you recall, Sniper 2 is our new electronic fuel injection system, which we discussed last quarter, is a marquee product for us and is our mainstream EFI offering. We also launched multiple accessories to enable enthusiasts to swap the modern 7.3 liter Ford Godzilla Engine platform into classic trucks and muscle cars including high mount accessory drive and oiling system and a low profile cast intake manifold. Plus we're expanding our offerings in modern truck, the new exhaust kits under our Flowmaster brand for the popular 2022 and up Toyota Tundra.

As the leading consumer platform for automotive performance enthusiasts, our events are critical for engaging consumers at the grassroots level. Summertime is the height of our event season. We held four major events this past quarter. All four of those events were held on our home turf, here in Bowling Green, Kentucky; LS Fest East, Ford Fest, Jeep Experience and MoParty. These events hosted over 75,000 enthusiasts, up over 12% year-over-year. These events give us unparalleled direct connection with our consumers and allow us to understand firsthand where the enthusiasts' automotive performance aftermarket trends are headed.

In addition to connecting with consumers in person, digital engagement is critical to our success and through activating on our Q3 events, we were also able to partner with popular social influencers with over 29 million followers, enabling us to continue to build up our digital community and social engagement. To promote our Sniper 2 launch, we also worked with key digital media partners such as Hot Rod Garage, HP Academy, MotorTrend's Engine Masters and FordMuscle which generated 4.8 million digital impressions.

We are also bringing in new leaders to continue to elevate our customer experience, increase product innovation and drive growth. We engaged the former Chief Marketing Officer of Bridgestone to lead our customer experience marketing team. Then in our effort to increase innovation and implement a comprehensive product stage-gate system across our business, we hired a new Vice President of Product Management with extensive experience at Tier 1s like WABCO. We also see the OEM performance aftermarket as a growth vertical for us and hired a new leader with extensive OEM experience with major tire manufacturers and Fox Factory to lead this for us.

As you'll see on Slide 7, we finished up last week with a strong presence at SEMA in Las Vegas. We continued our leadership in product innovation by winning SEMA's Best Engineered New Product award with our new Holley Easy-Level Fuel Level Sender, which uses LiDAR technology to precisely measure the depth of fuel remaining in your tank. It prevents the need to set up float-type fuel level sensors, which saves time and improves accuracy. Pictured here, accepting the award is John McLeod, the leader of our Classic Instrument and Detroit Speed brands.

We also took home a number of global media awards. These awards are nominated by premier journalists from throughout the world that come to the SEMA show with the purpose of

identifying and discovering what new products are likely to succeed in their home countries. Included in that list were the following Holley performance products, our Sniper 2 EFI system, our Detroit Speed 1964-1970 Mustang front-end kit, and our Hooker Blackheart brand's LS Swap Stainless Steel Manifolds.

On the right side of the slide, you can see another project we're really excited about that debuted at SEMA. Through our Detroit Speed brand, we are one of the premier resto-mod builders, and that reputation gets recognized by some of the biggest celebrity names out there. Plus, it gives us a platform to promote all the possibilities that Holley can provide on your next project.

At this year's SEMA, we displayed a project we've been working on for comedian and actor Kevin Hart. As an avid auto enthusiast, we were delighted Kevin chose us for his build on this 1969 Pontiac GTO. In addition, our APR brand, which focuses on European platforms also won an innovation award at SEMA from one of our major customers for its direct Turbo Replacement Kit for the Audi 3.0 liter engine found on many 2018 and up platforms.

Last quarter, we introduced you to our three fundamental steering principles. You can see those on the left side of Slide 8. We expect to make these principles a reality by focusing on the four key areas to the right. The first centers around our teammates in making Holley a great place to work. The second area we focus on is enhancing our operations to not only remove nonvalue-added activities, but also ensure we have the right products available and the right inventory levels to serve the market. Plus, we must offer enthusiast consumers and distribution partners the best omnichannel customer experience in our space.

The third key area is optimizing acquisitions. Holley has acquired some amazing brands and businesses over the last few years, and we realize that each of these has their nuances. We must foster these differences to enable them to continue to deliver in their distinct markets. We are working to ensure that there is no one-size-fits-all approach and that the appropriate structure is in place, leadership, and accountability to make sure these businesses achieve outsized market growth in their respective areas.

Finally, we are putting a focus on all customers first. This not only includes our fabulous base consumers, but also our loyal distribution partners. We are finding ways to grow and expand our sales channels in an effort to reach and serve a broader range of enthusiasts.

On to Slide 9. The transformation occurring in our organization is extensive as we work to grow the company both organically and inorganically. There are four areas we'd like to highlight for today's call, and they include the marketing and sales evolution, cost to serve, enhanced product development and the rollout of our new organizational structure. When it comes to marketing and sales capability, there is a comprehensive evolution happening. We're aligning our resources around the globe increasing our customer engagement with both our consumers and distribution partners and focusing on key areas of opportunity with the greatest impact.

On the distributor side, we are finding more ways to partner with key distributors in our consumer verticals to win a larger share of their business and identify mutual growth opportunities. We have also refocused resources to be even more customer focused and have advanced what was our call center into a new customer experience and engagement center. This new path with additional resources and is rooted in providing the highest level of customer support. We are investing in our digital capabilities to offer the leading experience in our space to attract and convert more customers through our own as well as third-party consumer and distributor platforms.

We are also focused on improving our cost position through a project we put in place called cost to serve. With some outside assistance and by combining data sources that were previously not available, we're able to identify by product category the cost to serve various customer types. The focus of this project is on both the inbound cost of the sourcing of the components for a product as well as the internal and external distribution of the product and after sales support that is required for us to serve the various channels. Now not only are we finding low-hanging fruit within efficiencies in our operations, but at the same time, we are uncovering ways to improve our customer service. Now that's definitely a win-win scenario.

Product innovation is key to our business and with so many great brands and categories, we needed a more refined structure and process to manage our product development efforts. This has meant installing seven new consumer verticals with leaders to steer that development across the key platforms and categories. We're also creating a robust product development roadmap by category and implementing a product development phase gate system with a goal of filtering out low-return projects and elevating the highest priority product launches in the organization to ensure they are receiving the necessary resources to have successful market adoption.

To help unlock the potential of this great company, we are instituting a new organizational structure. This new structure better focuses on the needs of the consumer, accelerates product development, enhances customer service, and drives clear accountability and responsibilities in the company. The new structure is intended to be as cost efficient as possible. Through in-depth input from our stakeholders, we settled on a matrix structure. It comprises 10 product categories that will be focused on executing a business plan developed in conjunction with our seven consumer vertical leaders who will drive the strategy across the business as to what platforms and what products we are targeting to bring to market.

Additionally, we've developed a support structure at the home office that ensures we are providing our leaders with the right amount of functional support and resources to execute their strategies efficiently and effectively. One of the goals of this organizational structure is to drive empowerment within our brands with guardrails of support and direction. All this change has required an extensive change management focused with greatly enhanced communication across our company.

On Slide 10, you can see our new consumer verticals. These consumer verticals align very closely with how SEMA and other organizations in our space look at the market. Now legacy Holley was

focused on classic truck and muscle, which we've shown a clear leadership position in but the biggest areas of opportunity based on our consumer market segmentation exists in modern truck, Euro and off-road, which is informing much of our go-forward strategy. With our vertical leaders focusing more on the needs of the consumers, which includes where they shop, what vehicles they've purchased and what products they are interested in and allows us to become hyper-focused on delivering platform solutions.

The world of the performance automotive aftermarket is vast and confusing, and consumers do not want to spend hours and hours trying to uncover who has what for the newer used vehicle they just purchased. They are increasingly going to specialists who understand the verticals and the respective platforms in them. Few companies, if any, have the opportunity that Holley does to present a comprehensive platform offering with all the product categories we cover. We have significant potential for growth by focusing and organizing all our products in a manner that best resonates with the consumer. More to come on this in the future.

Now I'd like to turn it over to Jesse to discuss our financial priorities and our Q3 results in more detail.

### **Jesse Weaver**

Thank you, Matt, and good morning, everyone. Matt and I were extremely pleased with the results the team was able to deliver in the third quarter. We ended the quarter with year-over-year net sales growth and strong improvements in profitability across both gross margin and adjusted EBITDA. As Matt already alluded to, we believe our team's efforts to transform the organization and optimize our operations are taking hold and are driving improved financial performance. These efforts have had a positive impact on our ability to generate strong free cash flow and pay down debt.

As a reminder, on Slide 12, our key financial priorities for the year have been restoring profitability, improving free cash flow, optimizing working capital, and deleveraging our balance sheet. These initiatives are firmly on track and are evident in our year-to-date results. So far for fiscal 2023, our cost initiatives are ahead of schedule and have delivered \$30 million of year-over-year savings, which is in line with our original target, and we are now expecting to capture approximately \$35 million in total for the full year.

We have also delivered significant improvements in free cash flow. Year-to-date, we have generated \$54 million of free cash, which is up \$53 million compared to the free cash generated year-to-date in 2022. Supporting our free cash flow initiatives, the efforts to optimize working capital are also taking hold as we stabilized inventory returns from the significant headwinds we experienced in 2022. Lastly, as we have highlighted in prior calls, Holley is intently focused on paying down debt and reducing leverage. In line with this commitment, we were pleased to pay down \$25 million in principal against our first lien term loan facility in September.

On Page 13, we've laid out a summary of key income statement line items. As I mentioned earlier, we are pleased to see a return to year-over-year net sales growth and significant improvements in profitability as measured by gross margin and adjusted EBITDA.

On Page 14, we've highlighted net sales for the quarter, which increased \$2 million or 1% versus Q3 of 2022. Our net sales growth was largely driven by strong growth within our electronics category, which increased approximately 13% as the team made tremendous progress on past dues in the quarter from their proactive efforts on chip procurement.

Net sales in the third quarter benefited from \$8 million in the reduction of past dues across both electronics and nonelectronic categories, which can be found on Page 15. This marks the seventh consecutive quarter of past due reductions overall since the peak of \$56 million in the fourth quarter of 2021. And for the first time since 2020, we made meaningful progress on electronics past dues, which were reduced by nearly 50%, down to \$5.5 million. As of the end of Q3, past dues on electronics were the lowest we've experienced since Q4 of 2020.

Turning to gross margin on Page 16, you can see that our gross margin of 37.3% is up 600 basis points compared to 31.3% last year. This strong increase was primarily driven by meaningful improvements in freight, lower warranty expense and some favorable impacts on product mix.

Moving to Slide 17, adjusted EBITDA for the quarter increased \$13.3 million, which is an increase of more than 80% over the prior year. This resulted in an adjusted EBITDA margin of 19%, which is 800 basis points better than the 11% adjusted EBITDA margin from Q3 of 2022. Our year-over-year adjusted EBITDA improvement was driven primarily by operating improvements as can be seen in our gross margin results as well as lower SG&A expenses.

For the third quarter of 2023, SG&A, excluding equity compensation, was \$26 million, down \$3 million from \$29 million in the third quarter of 2022. The \$3 million reduction is primarily driven by our efforts related to costs to serve and optimizing freight. SG&A excluding equity compensation at roughly 17% of sales versus 19% of sales in Q3 of '22 remains in line with historical trends for Q3 and reinforces the team's original commitment to cost containment coming into the year.

As can be seen on Page 18, our EBITDA results for the quarter, combined with cash generation from improvements in inventory, resulted in strong free cash flow of \$21.7 million. Importantly, this is a continuation of the solid cash generation we delivered last quarter and represents roughly a \$32 million improvement when compared to the third quarter of last year.

Moving to Slide 19, our free cash flow has been a significant contributor to the reduction in net leverage we have experienced year-to-date. We ended the quarter with a net leverage ratio of 4.89 times, which is meaningfully below the covenant that is outlined in our amended credit agreement and down from 5.58 times at the end of last quarter. This is also below the original debt covenant of 5 times. Our previously announced debt paydown of \$25 million is directly in line with our commitment to prioritize near-term debt reduction, and at current rates, is

expected to reduce our cash interest expense and benefit free cash flow by roughly \$1 million on an annualized basis.

While we no longer need the amendment, given our net leverage ratio is below the covenant originally put in place, we are keeping it in place to ensure we have the financial flexibility needed to continue making progress on all our strategic initiatives. In the near term, we expect continued strong free cash flow to support further debt paydown and we'll be providing investors with more guidance on net leverage targets during our year-end call in early 2024.

Moving to Slide 20. As it relates to Holley's long-term debt profile, I would like to remind investors that we proactively entered into a costless interest rate collar earlier this year that hedges \$500 million of our debt against 3 months SOFR rate fluctuations through February of 2026. Taking these steps earlier in the year, combined with our efforts to prepay our debt, has greatly reduced our exposure to Fed interest rate policy and set us up to continue making progress on both cash flow and maintaining our leverage below our original net leverage covenant of 5 times.

Now I'd like to cover our revised 2023 outlook on Slide 21. Given our year-to-date results, we are raising the bottom end of our net sales and adjusted EBITDA guidance. For the full year, we are now projecting net sales in the range of \$645 million to \$675 million and adjusted EBITDA between \$123 million to \$128 million. While the reduction in past dues this year is encouraging, it does provide a tailwind to results. But as we look ahead to the fourth quarter and next year, we'll be more intently focused on order growth trends for guiding our perspective on near-term performance.

With that in mind, a likely scenario could be that our full year revenue could be positioned in the bottom half of the guidance range, while efforts on operating efficiency and cost containment support our full year adjusted EBITDA to be towards the top half of the guidance range. And on a sequential basis, adjusted EBITDA would normally be expected to come down in the fourth quarter, which is consistent with historical trends. This is largely driven by the impact of our holidays promotion and the step-up in outbound freight in SG&A from an increase in sales going through our D2C channel, which has a higher percentage of small parcel freight charges.

We are also narrowing our CapEx guidance range to between \$6 million and \$8 million from the prior range of \$5 million to \$10 million. Our depreciation and amortization guidance range has been adjusted to between \$24 million and \$26 million, and our interest expense expectation excluding the mark-to-market on the collar is unchanged and remains \$58 million to \$62 million. In closing, we are encouraged by the return to top line growth we saw in the quarter, supported by the significant reduction in past dues and most notably on electronics. Our year-to-date performance has been strong, highlighted by our gross margin and EBITDA margin performance, cash generation, working capital management and focus on reducing leverage.

In addition, I'm even more excited about the opportunities that lie ahead and the long-term growth prospects of Holley and the industry as a whole. Armed with leading brands and a strong

focus on operational excellence, we look forward to continuing to build a path towards gross margins of approximately 40% and adjusted EBITDA margins greater than 20%.

This concludes our prepared remarks, and we'd now like to open up the line for questions.

**Ross Collins**

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

**Operator**

Thank you. Again, at this time we will be conducting a question-and-answer session. If you would like to ask a question please press "\*" "1" on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may also press "\*" "2" 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 "\*" keys.

Our first question comes from the line of Brian McNamara with Canaccord Genuity.

**Brian McNamara**

First, I'm curious how Sniper 2 has been received, particularly at SEMA last week, given I believe it was the first time you did new product seminars with it. And if you care to share how revenues are trending on the product relative to your expectations.

**Matthew Stevenson**

Brian, this is Matt. I mean we're very excited about Sniper 2. As you saw in the prepared remarks, won those global media awards and received a ton of attention at the show relative to our training sessions and both with the consumers that attended the show towards the end of the week and our distribution partners in the beginning half of that week. And it's a product that really is going to example how we move forward on product launches in the future by really partnering with the market, getting it ahead with a proper launch calendar, partnering with our distribution to make sure we have inventory in stock and are driving the right promotional and consumer engagement efforts around it.

So very excited about where that's trending. As right now, we're going to give specific revenue on products, but we're very excited about where it's headed.

**Brian McNamara**

And then secondly, I mean, I know Jesse kind of covered this a bit a few moments ago. Your implied Q4 guidance on the top line is pretty wide, I think minus 9% to plus 11%. I know the benefit of past dues winding down is part of that but are there any other puts and takes we should be aware of?

**Jesse Weaver**

No, Brian. I think that the main thing on the top line piece that we're continuing to focus more and more on is we've done a great job on the past due side is just what the order trends look like.

And I would say that in the guidance, we're looking at flat to slightly positive on order trends. And on the past due side, we're looking to make continued progress there to hopefully, based on the path that we have as a team internally, get that down to \$4 million by the end of the year. And so I think one of the things that we called out in this is we feel like really good about the work the team has done on cost to serve and the continued opportunities there to be able to prop up the EBITDA margin even in light of any headwinds in the range on the top line. But this is, hopefully, that gets you what you need on sort of the drivers there.

### **Operator**

Our next question comes from the line of Joe Altobello with Raymond James.

### **Martin Mitela**

This is Martin on for Joe. I was just wondering if we can get a little more color around gross margin expansion? I know you said 600 bps and it included a meaningful price, some mix and lower warranty costs. Just wondering if we can get some idea around what those numbers are that bridge and whether that's sustainable going into the new year?

### **Jesse Weaver**

This is Jesse. The big part of this on the gross margin side, just to kind of give you some rough numbers, about nearly 550 to 600 basis points of it alone is just from freight and with the next piece of it really largely being the warranty expense.

I think as a reminder, Q3 of last year, we had a pretty meaningful warranty charge as it relates to one of our key suppliers actually sending us a lot of warranty claims a little late in the process versus what we're typically used to. So those are the big drivers. We did call out a slight benefit from product mix, but the two biggest ones, like I said, were freight and warranty expense.

### **Martin Mitela**

I know you mentioned you want to get down to about \$4 million in past dues. Just wondering if this is evenly spread around your segments or is it going to be particularly electronics? Just trying to get an idea of that mix.

### **Jesse Weaver**

Yes. I mean I think you can see in the mix, electronics versus non-electronics. We ended the quarter with electronics at about \$5.5 million. We have to make progress on all of them. We've traditionally seen that in Q3, Q4, we do make good progress on those. And I think one of the areas that we called out thus far in the call, that's always been for at least a while, not always, but for the last several quarters, question mark is on the electronics procurement for chips.

So seeing that, we've got that chip supply procured and the team is actively working very quickly to get these products created and out the door and the visibility we have on the inventory side in non-electronics, we feel like we should make progress across both big buckets to be able to get us down to \$4 million, which is generally what we would expect is an ongoing sort of sustainable level with some slight improvement from there kind of at some point next year.

**Operator**

Our next question comes from the line of John Lawrence with Benchmark.

**John Lawrence**

Quickly, Matt, as you talk about redesigning the organizational structure, and I know Sean has moved up into that product development, can you talk a little bit about now that you've had a little bit more time to put that together what's the real benefit? Is it better speed to market? Is it a broader sense of priority of like the Sniper 2 of something coming to the forefront quicker to get to market? Explain the process a little bit and how you think that benefits you in the next couple of years.

**Matthew Stevenson**

We're really excited about this direction we're headed in the organization. And I think you touched on a number of the major points.

It's really about unlocking growth and driving that speed and growth. And when you look at where Holley has been really successful in the past around classic truck, classic muscle and modern muscle, there are segments that range from really about \$1 billion to \$2.5 billion each in the SEMA data. When you look at really where some of the large growth opportunities are like modern truck, that's over \$14 billion. You look at euro, Asian imports, which are both over \$7 billion, then off-road, which is about \$6 billion.

You know it's really setting up our vertical leaders to unlock growth in these other categories, which I'd say, have not been primary focuses in the past. And at the same time, within those verticals, there are certain platforms that really people want to modify and that are the picks of the enthusiasm. And we want to make sure we're bringing comprehensive solutions to the forefront of the market quickly to go after those platforms.

And so with those changes as well as this highly structured phase gate system in the organization, we can now uncover the product innovation faster and make sure we're resourcing it to bring it to market more quickly and prioritize those opportunities. So we're really excited about the focus this is going to bring, bring us closer to the consumers and drive the growth.

**Operator**

Our next question comes from the line of Phillip Blee with William Blair.

**Sabrina Curran**

This is Sabrina on for Phil. How did the direct-to-consumer business perform during the quarter? And what was that as a percent of sales?

**Matthew Stevenson**

This is Matt. As we talked about on our last earnings call, our goal is to meaningfully grow D2C as well as a number of other channels in our business. But with that said, throughout our business, there's going to be a lot of ebbs and flows relative to that D2C percentage as a total percentage of our business. And we just don't think that indicating on a specific percentage is the best

indication of the performance of the overall business. We encourage you to look at the top line and bottom line growth of Holley in the future.

**Operator**

Our next question comes from the line of Christian Carlino with JPMorgan.

**Christian Carlino**

My first question is on what's your general view on the current health of the enthusiast customer? Are you seeing any increased caution from either resellers or the end customers later in the quarter and quarter-to-date? And that's my first question.

**Matthew Stevenson**

As I had in my prepared remarks, Q3 for us is typically our lowest order demands from a seasonal perspective. And we're seeing those order demands normalize, as we've talked about in previous quarters. There's a lot that happens in the fourth quarter in terms of as our enthusiast consumers start to buy products to prepare for their builds that they begin in the winter, ultimately to have those cars on the road in the late spring and the summer.

So there's a lot that goes on in the fourth quarter for us and various historic promotions and things of that nature. So really looking forward to seeing how the demand shakes out over the fourth quarter to get a better gauge of what we're going to see going into '24.

**Christian Carlino**

And I guess, depending on the top line but as you look ahead, how should we think about the path to the 40% gross margin and 20% EBITDA margin targets? Is there enough self-help and cost savings that you can get there without hitting the 6% to 7% top line growth?

**Jesse Weaver**

I think that as Matt has been here, and we've talked about the cost to serve project and the work that we've done that I think you can see some of the results in Q3 and Q4, we do think that there's still opportunity for us to drive further efficiencies in the operations in our cost overall to yield even better margins at comparable sales levels. I think it's a little early for us to say exactly when we would hit the 40%-20% as it relates to growth. I mean, growth would be a part of that equation. But long term, this industry has demonstrated resiliency in most markets.

And as we get into '24, we'll have a better sense as we see Q4 and the first few weeks of Q1 of '24, to be able to give you a sense as to that 40%-20%, something that we would be able to achieve in the next 12 months or what does the timing look like? But nothing has changed structurally like we said before, in the industry. There's no Netflix moment in the auto aftermarket that gives us any caution to say anything other than getting back there is definitely achievable from what we can tell today.

**Operator**

Our next question comes from the line of Joe Feldman with Telsey Advisory.

**Joseph Feldman**

I wanted to just kind of follow up on that last question about the gross margin. Like I get that the 40%-20%, longer term, it will take some time. But what about in the near term? Like should we assume you guys can sustain this kind of high 30s, 37% plus in the next 12 months or so? Or like should we start to see a more steady rate over the coming months?

**Jesse Weaver**

I think it's important to kind of look back at historical trends in the quarterly seasonality of this margin, not to get into the accounting nature of our business being a manufacturer business with cap variants and all those fun things but when you look at sort of Q1, Q2, it's typically when we see our higher gross margin rates as we get leverage on fixed costs. And then Q3, Q4, I mean, I think it's pretty sequential as you can see, we dropped from a revenue perspective due to seasonality, about \$20 million from Q2 to Q3 with 50% flow-through in any given short period of time, that explains sort of that drop quarter-to-quarter.

And what we're targeting when we say 40%-20% is not necessarily any given quarter otherwise, we would have probably rung the bell in Q2, but rather a full year view of what the margin profile would look like for gross margin and EBITDA. And so that, to Christian's earlier question is what we are trying to get our arms around for what is the timing of being able to achieve that. And I think to what Matt said and I repeated, seeing how Q4 shakes out in the early parts of Q1, we'll have a better indication as we finish up our planning for next year.

**Joseph Feldman**

And then another question on just capital allocation. How should we think about capital allocation now? You've done a great job managing the balance sheet and we have made some (inaudible). Should we assume there's more to go there? Or will it be more continuing to invest in growth of the products? How will you allocate capital is the question?

**Jesse Weaver**

We've repeated throughout the year that getting our balance sheet in line and paying down debt with excess free cash flow, which we've generated a pretty meaningful amount this year and demonstrated our commitment to that with what we did in Q3 is our primary focus from an excess cash perspective.

I think as a reminder, this is a capital-light business. I mean, to be spending roughly \$6 million to \$8 million in capital in the year with a business that's generating this level of revenue, I think it shows you it doesn't take a lot of capital to grow the business overall.

So I wouldn't suspect if that's kind of what you're looking for, could there be investments on the capital side that would get in the way of us meeting our debt commitments? That is not at all something that we view as a real issue here as we drive for growth.

**Joseph Feldman**

So we should expect a little bit more of excess cash being used to pay down debt, I guess, in the near term?

**Jesse Weaver**

Well, as we see how the cash profile looks throughout Q4, it's something that, as we said in our last call for Q3, we were looking at, but we're not going to make any commitments at this time on what we would do with that. We just need to really see how the cash profile looks and have a discussion internally and with our board about what the right moves are.

**Operator**

Our next question comes from the line of Michael Baker with D.A. Davidson.

**Michael Baker**

So one clarification and then one follow-up question. The clarification, just to be sure I heard it right. So you raised your full year sales guidance towards the middle to high end, but you're saying the fourth quarter should be towards the low end of the implied guidance. I just want to make sure I heard that right?

**Jesse Weaver**

Yes. I think whenever you do those squeeze, Michael, that is exactly what we're saying is whenever we take a view of the range, we feel like it's based on what we've talked about seeing the revenue come in towards the mid to low end of the range for the Q4 implied number and the EBITDA being at the midpoint to slightly above and based upon what we talked about, which is feeling good about the cost savings that have been put in place and the efficiencies that we are seeing to kind of make the shape of that relationship work is where we would point investors for this call.

**Michael Baker**

So maybe I'll try to squeeze two questions into the follow-up. One, last quarter, you said third quarter and fourth quarter combined would be about 48%-52% split. It seems like, I think if I'm doing my math right, that might be a little different now. So what's changing? And then the real follow-up question is there's been no comments on like sell-in versus sell-through, what you're seeing from your customers in terms of stock levels, destocking, et cetera. Any color you can provide on sell-in versus sell-through or those kind of metrics, I think, would be helpful.

**Jesse Weaver**

Yes. It's a good question. And I would say, to your point, you're reading what we talked about and what we're guiding to right now, just right on where from a shipments perspective, I think what we are seeing based on our imputed guide here is about a 50%-50% split between Q3 and Q4. The order split, I think, is really kind of what has changed there where we've seen the order trends that we're taking a look at and the promotions that we're putting in place, fully expecting these to be big drivers for Q4.

But I think it's the question of the timing of when those come in and our ability to get those out because a lot of these orders come in, in December and needing to kind of put all cylinders in gear, if you will, to get those out would really make the difference on how we're able to get more to that 48%-52%. But based upon what we're seeing now and what we're in this call, we feel like the guide kind of gets you more to the 50%-50% split. Can you repeat your second question because that's a lot of questions.

**Michael Baker**

Just sell-in versus sell-through, anything you can tell us about what you're seeing in terms of POS from your customers?

**Jesse Weaver**

Yes. I mean this is something that we do look at. I would say that we've talked about it a bit in the previous calls. We're not giving those specific numbers. But I would say that trends improved between Q2 and Q3, but certainly something that we continue to look at. And I would say that what we're seeing is imputed in our guide here.

**Operator**

And as a reminder, if anyone has any questions you may press "\*" "1" on your telephone keypad to join the question-and-answer queue. It looks like we have reached the end of question-and-answer session. I'll now turn the call back over to Matthew Stevenson for closing remarks.

**Matthew Stevenson**

Thank you. Slide 24 highlights the compelling thesis around Holley. This is an incredibly attractive market, driven by automotive enthusiasts. And this is not just a hobby for our customers. It's their passion and it's a lifestyle. And because it's more than just a hobby or trend, it weathers economic cycles extremely well. We have a massive addressable market, nearly \$40 billion that has seen decades of uninterrupted growth.

Holley is the industry powerhouse with a portfolio of iconic brands with a history of innovation. Plus, we have a track record of successful acquisitions and creating value through integrations and unlocking growth. We have a unique opportunity to create a transformational digital experience that will redefine the way our consumers and distribution partners interact with our brands. This will create a competitive advantage and drive growth.

All this leads to an attractive investment thesis with the business focused on delivering consistent organic growth of at least 6%, 40% gross margins, 20-plus percent EBITDA margins, sustainable free cash flow and a platform that enables value to be unlocked in strategic acquisitions. The combination of the attractiveness of our automotive and enthusiast marketplace and the great portfolio of Holley brands offers a fantastic investment opportunity.

Before we close, I want to thank all our teammates for everything that they do every day to deliver for our customers. I want to thank our incredible group of consumer enthusiasts who

support our brands as well as our distribution partners, many of whom have been with us for decades. And I want to thank you for your time today on the call.

We look forward to continuing to update you on our progress in future quarters. I hope everyone has a great holiday season that's in front of us, and we look forward to talking with you in the new year. Thank you, and have a great day.

**Operator**

And this concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.