

Holley, Inc.
Fourth Quarter 2022 Conference
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Presenters

Ross Collins, Investor Relations

Matt Rubel, Executive Chairman

Michelle Gloeckler, Interim President and Chief Executive Officer

Jesse Weaver, Chief Financial Officer

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

Q&A Participants

Joe Altobello--Raymond James

John Lawrence--Benchmark Company

Anna Glaessgen--Jefferies

Mike Swartz--Truist

Christian Carlino--JPMorgan

Alex Perry--Bank of America

Joe Feldman--Telsey Advisory Group

Operator

Good afternoon, ladies and gentlemen and welcome to the Conference Call to discuss the Results from Holley's Fourth Quarter 2022.

At this time, all participants are in listen-only mode. Later, we'll conduct a question-and-answer session and instructions for asking questions will be provided, at that time. We ask that participants limit themselves to one question and one related follow up, during the Q&A period.

Please be advised that reproduction of this call in whole or in part is not permitted without written authorization of Holley. And as a reminder, this call is being recorded and will be made available for future playback.

I would now like to introduce your host for today's call, Mr. Ross Collins, Managing Director of Alpha IR. Please go ahead.

Ross Collins

Thank you and good morning, everyone. Thank you for taking the time to join us, today. On the call with me today are Matt Rubel, Executive Chairman; Michelle Gloeckler, Interim President and Chief Executive Officer; Jesse Weaver, Chief Financial Officer; and 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 Harbor 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, S4 and S1 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 that statements will remain relevant and operative at a later time. Holley undertakes no obligation to update any information included 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 to Michelle Gloeckler, Holley's Interim President and Chief Executive Officer. Michelle.

Michelle Gloeckler

Thanks, Ross. Good morning, everyone, and thank you for joining us, today. As we enter the next chapter for Holley, I know I can speak for myself and the Board when I say that we are excited about the organization's focus supported by the incredible talent and depth of the organization and this leadership team.

This is a business built for enthusiasts by enthusiasts. Many of our associates have decades of experience in the industry and not only believe in our company vision to inspire and enable enthusiasts in their automotive adventures by bringing innovation, discovery and fun to motor life, but they also live our vision in their day-to-day lives, outside of Holley.

Our team's experience and direct connection to the enthusiast consumer as enthusiasts themselves is a strategic asset that underpins the foundation necessary for us to execute on our strategy and capitalize on continued growth in this category.

That strategy is built on five pillars: one, prioritizing key categories and platforms; two, product innovation; three, mergers and acquisitions; four, our consumer-focused channel strategy; and five, engaging and inspiring the enthusiast.

Moving forward, we are confident that we have the right team and the right plan in place to drive shareholder value.

Our markets remain fundamentally strong and although sector demand is experiencing a normalization to pre-COVID levels, we firmly believe our industry is capable of growing organically at 6% to 7%, over the long run.

Given our unmatched scale, market leading brands, new product innovation, direct-to-consumer powerhouse and proven M&A platform, Holley is poised to grow at or above the market. We continue to believe this business can return to 40% gross margins with EBITDA margins greater than 20% in the near future.

While we did not meet these targets in 2022 due to a combination of macroeconomic and cost headwinds, we are implementing several initiatives directly tied to our strategic pillars to drive both top and bottom-line growth.

These initiatives are beginning to gain traction in 2023 and will be contributing factors in our efforts to deliver free cash flow growth in 2023 and return to long-term profitability levels. 2022 was a challenging year for Holley and one that surfaced many areas of improvement for our broader organization.

Despite these challenges, I want to sincerely thank our employees for their tireless efforts to deliver on our strategic vision and also to acknowledge the wins and successes we achieved, this year.

We are pleased with the continued solid demand we are seeing through our DTC sales channel. For the full year, DTC sales were \$149 million, up 27% or \$32 million compared to 2021, which is a new Holley record. These DTC sales represented 20.9% of total sales in 2022, compared to 16.3% in 2021.

We look forward to continued growth in the DTC channel, as it is a core pillar of our growth story and directly connects us with our enthusiast customers.

Holley's M&A platform continued to drive value in 2022, with three additional acquisitions made during the year but, just as importantly, by successfully integrating acquisitions made in previous years.

Over the past three years, our team has completed 16 acquisitions, integrated 13 ERP systems and consolidated 160,000 square feet of facilities. These acquisitions contributed nearly \$175 million of sales in 2022.

Furthermore, our action to integration efforts will allow us to capture \$10 million in annualized cost synergies, over the next 12 to 18 months.

The success of our self-funded enthusiast events continues to surpass our expectation and is a key pillar of our consumer engagement strategy.

We hosted seven events in 2022, with a total attendance of 106,000 individuals, which is an increase of 16.9%, over last year. It's a true testament to the growing multigenerational Holley community.

As we outlined last quarter, past due orders remain elevated due to various operating headwinds, including the supply chain and our strained ability to receive chips in a timely and reliable fashion.

During the quarter, we were able to reduce our past due orders by \$9.6 million, with approximately 60% of that reduction coming from our mechanical product category. With that said, total past due levels remain elevated at \$27 million at the end of the quarter and are concentrated in our electronics category.

As we looked at 2023, Holley is a more focused organization and our team is ready to execute on all pillars of our strategy. Company-wide execution will be critical as we continue to face various headwinds to our business, including a normalization of demand from COVID levels, heightened inventory levels and broader supply chain constraints.

Additionally, inflationary pressures have persisted, causing elevated input costs, as well as heightened freight costs. While general supply chain congestion has reduced and helped us make progress on our mechanical products, we continue to experience headwinds related to the availability of microchips.

The challenge we have with semiconductors is unique to us as our Holley EFI product line, we call it HEFI, is designed today on semiconductors that are not widely available. This is both a product lifecycle management and an engineering opportunity.

Engineering is intently focused on redesigning the product line to support more accessible chips. Product lifecycle management processes are being improved to better anticipate reduced supply on critical components and prioritized engineering resources, ahead of any potential challenges.

Redesign efforts take time. So, we will continue our efforts to secure supply where possible on the spot market for these critical components, which will help minimize further anticipated top and bottom-line headwinds, during 2023.

In the face of these uncertainties, I can assure you that both the Board and our management team are committed to addressing these issues, head on. This will include dedicated efforts in the year to align our cost to key pillars of our strategy by prioritizing categories and platforms, maximizing and accelerating our M&A synergy capture and returning to operational excellence, through refinement of our operations.

Because of our efforts to refocus the organization on prioritized categories and platforms, we have been able to, successfully, optimize our operations and remove costs from the business.

In Q4, we rationalized more than 20,000 SKUs across 18 brands while reassessing our overall inventory management processes, reevaluating contract manufacturing options and drop-ship arrangements which, combined, are expected to improve working capital management and our path back to meaningful free cash flow in 2023.

Additionally, our team is driving synergy capture from our previous acquisitions, and in 2023 the team is expected to deliver an incremental \$3 million to \$3.5 million in savings, through consolidation.

These efforts, combined with initiatives Jessie will talk about, including improvements in shipping costs and right-sizing our cost structure, are all expected to improve profitability on our path back to 20% EBITDA in the near future.

With a large, vibrant and loyal customer base, strong innovation pipeline and a powerful roster of brands with robust sales channels, we believe Holley is in a solid position to deliver long-term growth for our shareholders.

Fueled by a strong focus on our strategy, clear prioritization of initiatives and depth of our leadership team, we will be emerging as a much stronger company in 2023. We look forward to sharing our progress with you in future calls.

With that, I will now pass the call to Jesse to provide an overview of our financial results. Jesse.

Jesse Weaver

Thank you, Michelle, and good morning, everyone. Holley delivered net sales of \$154.2 million in the fourth quarter, a decrease of \$25.6 million or 14.3%, compared to the fourth quarter of 2021.

Non-comparable sales associated with acquisitions contributed \$7.3 million or 4.1% of year-over-year growth.

The remaining comparable sales decreased by \$33 million or 18.3%, compared to the prior year quarter offsetting the impact from acquisitions. Past due orders declined by \$9.6 million in the quarter to \$26.8 million, driven primarily by improvements in our mechanical product availability.

We are still seeing elevated past dues in our electrical products, which continue to be an opportunity and are expected to impact sales potential in 2023.

Sales levels in the quarter were below our expectations, driven both by weaker customer orders, as well as supply chain impacts. Orders were down 10% from the prior year, with the weakest year-over-year performance in our exhaust safety products.

As Michelle mentioned, we are seeing a normalization of demand trends back to pre-COVID growth rates. Prior to any COVID impacts on demand, the team had reported that our addressable market grew at roughly a 6% to 7% compound annual growth rates, between 2001 and 2019.

To the extent our comparable sales growth rate exceeded that level between 2020 and 2022, demand was likely positively impacted by consumer spending habits from stimulus related to COVID shutdowns.

While we believe this approach is an appropriate guide to better understanding demand normalization, the approach would not factor in any potential upside from share gains or new market entrants.

While we believe demand normalization maybe a headwind in the near-term, we still expect the market to grow 6% to 7% per year in the medium to long-term and for Holley, organically, to perform in line with the market with upside potential from innovation and mergers and acquisitions.

Despite disappointing sales results for the quarter and full year, our D2C channel delivered strong year-over-year growth of 16% in the quarter and 27% for the full year and we know our ongoing success in the D2C channel will continue to bring us closer to our enthusiast customer base.

Gross margin decreased from 41.6% last year to 30.7% in the fourth quarter of 2022. The decrease in gross margin can be attributed to manufacturing inefficiencies driven by deleverage on fixed cost, supply chain constraints, higher one-time product rationalization charges and continued inflationary pressures. After adjusting for the one-time product rationalization charges of \$4.5 million, gross margin in the fourth quarter was 33.6%.

Total selling, general and administrative expenses increased \$9.1 million to \$54.1 million in the fourth quarter. The increase in selling, general and administrative cost was driven by a \$12.7 million increase in non-cash compensation expense related to equity awards, which included an \$11.4 million cumulative adjustment related to the early vesting of profit interest units granted by the Holley stockholder, prior to the business combination.

Outbound shipping and handling cost increased \$2.6 million, reflecting inflationary pressures on shipping companies combined with growth in D2C. Partially offsetting these increases with a decrease in administrative and sales personnel costs, reflecting the implementation of recent cost saving initiatives and synergy capture from prior acquisitions.

We recorded a net loss of \$15.2 million in the fourth quarter of 2022. Net income for the quarter was favorably impacted by a \$7.4 million non-cash decrease in liabilities for warrants and earn-out shares. On an adjusted basis, net loss was \$22.6 million versus net income of \$9 million in the fourth quarter of 2021.

Adjusted EBITDA decreased to \$15.1 million in the fourth quarter, down from \$36.1 million in the fourth quarter of 2021.

Similar to the impacts on gross profit, manufacturing inefficiencies from lower sales, driven by demand normalization and supply chain constraints, combined with inflationary pressures were the primary headwinds to our EBITDA performance, during the quarter. Please note, product rationalization charges are added back in the adjusted EBITDA calculation.

Turning to our balance sheet, we experienced a significant increase in inventory during 2022. Inventory increased by \$49 million in total for the year, which was driven by many challenges that either have been or are actively being addressed, including high minimum order quantity restocking to address past due challenges and less purchasing focus on prioritized categories and platforms.

From a liquidity perspective, we ended the quarter with \$26 million in cash and only \$10 million drawn on our \$125 million revolver.

As we look ahead to 2023, we are projecting net sales in the range of \$625 million to \$675 million and an adjusted EBITDA in the range of \$108 million to \$122 million. For modeling purposes, we are also providing guidance for CapEx, depreciation and amortization and interest.

We expect 2023 results to include capital expenditures of \$10 million to \$15 million, depreciation and amortization between \$23 million and \$25 million and interest expense in the range of \$60 million to \$65 million.

As Michelle already outlined in detail, we are committed as a team to our strategy by prioritizing our key categories and platforms, capturing cost synergies from previous acquisitions and operational excellence.

We fully expect to deliver on these initiatives in 2023, and these expectations are reflected in our provided guidance ranges. In addition to our outlook, I would like to provide a few financial priorities for 2023, as well as some expectations around key metrics.

Since I joined Holley late last year, the key objectives for our team have been to restore Holley's profitability, improve free cash flow, optimize working capital, and delever the balance sheet. These will continue to be the main objectives for our team this year, while we pause on M&A activity in 2023 and focus M&A efforts on finalizing successful integrations and synergy capture.

As it relates to our sales outlook in 2023, we expect the continuation of the demand trends we experienced in the second half of 2022. This normalization of consumer demand, coupled with continued chip shortages impacting our HEFI product line will likely be a headwind throughout 2023.

As it relates to our cost structure, we have taken several steps to capture acquisition synergies, improve our freight strategy, and right-size our operating structure. In total, we expect these efforts to deliver approximately \$30 million of year-over-year cost savings in 2023, with \$15 million coming from SG&A as a result of a recent reduction in force and expected synergy capture.

We also expect \$15 million to come from gross margin, largely driven by improved shipping cost as a result of a recently negotiated contract with a new third-party logistics provider.

As it relates to working capital levels and free cash flow, we are beginning to see inventory turns come back in line with historical pre-COVID levels. With inventory positions outside of electronics in better shape, we do not expect the free cash flow headwinds we experienced from working capital over the course of last year.

While there may be some tail effects in Q1 of this year, we expect changes made in Q4 of 2022 and early Q1 of 2023 to flow through beginning in Q2. From a capital investment perspective, we'll continue to be a capital-light manufacturing business.

And in 2023, we will be heavily focused on making disciplined capital investments throughout the year, while exploring further manufacturing outsourcing opportunities where it makes financial sense.

Turning to leverage levels and our interest rate exposure, our team has taken several necessary steps to de-risk our interest exposure and ensure we have the financial flexibility we need to improve free cash flow, through the execution of our plans in 2023.

First, as it relates to overall net leverage levels, this morning, we filed the details of an amendment to our credit agreement that provides us with financial flexibility through Q2 of 2024.

Second, in an effort to reduce exposure to floating interest rates, we entered into a costless interest rate collar that hedges \$500 million of our debt against 3-month SOFR rate fluctuations above 5% and below 2.8% to mid-February of 2026. Additional details on the amended credit agreement and interest rate collar can be found in our supplemental earnings materials posted on our website.

In closing, while we face multiple economic uncertainties in the near-term, including continued cost pressures and a potential recessionary environment, we are extremely bullish on the long-term prospects of our business and sector.

We firmly believe that nothing has, fundamentally, changed in the performance automotive aftermarket and that the consumer enthusiasm for our products has been unwavering. For these reasons, we believe our focused efforts in 2023 will generate free cash flow growth and get us back on track to achieving our long-term gross margin and EBITDA targets of 40% and 20%, respectively.

That concludes our prepared remarks. Ross, we can open up the call for questions.

Ross Collins

Absolutely, Jesse. 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

Mr. Altobello, please go ahead with your question.

Joe Altobello

Great, thanks. Hey, good morning, guys. I appreciate the question. I guess first on the guide, I want to understand better what you're assuming in terms of demand and supply chain. Sounds like you're not expecting anything dramatic to change on that front. So, maybe help us understand how we think about those two dynamics, throughout '23?

Jesse Weaver

Hey, this is Jesse. It's a good question. And the way that we're thinking about the guide is you've got--we've tried to do a good job in the supplemental materials of illustrating sort of our assessment of how much the normalization of demand is kind of coming in to 2023. And when you look at sort of the midpoint of that you're in the 5% range of headwinds, year-over-year.

And we're assessing probably 4% of that is related to 4% to 4.5% related to normalization of demand. And the balance of it largely being just a continuation of the more recent trends we've seen, as it relates to chip availability. So it doesn't assume any improvement in some of the more recent months. But that would be upside, if the environment changes.

Joe Altobello

Okay, that's very helpful. Maybe second question, in terms of D2C growth, obviously, it's outperforming the rest of the company. Is there any issue in terms of channel conflict between yourselves and some of your distributors and resellers for example, given the growth of that channel?

Michelle Gloeckler

Yeah, this is Michelle, thank you for the question. And you're correct, with 27% DTC growth being 20% of our overall at almost \$150 million. We're happy with that because it does link us directly with the enthusiast. But to your question on does it create channel conflict.

We have great relationships with our distributors, wholesalers, small shops, especially those that add service to the mix. So they're a vital part of our business mix in the way we reach our customers and enthusiasts. The way I like to think about it is we want to reach our enthusiasts, however they want to shop whenever they want to shop.

And if they need services, our distributors and wholesalers and independent shops, are—they're value add to that. So we're really trying to let this be an enthusiast led demand piece.

Joe Altobello

Okay, great. Thank you.

Operator

Thank you. Our next question comes from the line of John Lawrence with Benchmark Company. Please proceed with your questions.

John Lawrence

Great, thanks for the chance to ask questions. Michelle, can you talk a little bit about the fact that a lot of initiatives a lot of strategic changes, I guess it's—we get sort of a debt concerns out of the way liquidity, a lot of these strategic initiatives. Can you—by any chance, put them in buckets as far as what has to happen first?

And most importantly on the innovation piece, I mean, I've always viewed that innovation piece is what sets you apart from the rest of the industry. And how has the cost cuts, etc., expected that sort of innovation piece? And when you talk about reengineering some things on the chip side, can you walk through a little deeper dive there, please?

Michelle Gloeckler

It would be my pleasure. And thank you for the question. And also, thank you for your understanding on the reengineering of the chips. That's a very important point. I'm going to try to put things in some sequential buckets for you because I do think there is an order. When you talk about the cost savings, both operational excellence, which is tied to SKU rationalization.

So, we mentioned that we were able to rationalize 20,000 SKUs across 18 brands. That will bring efficiencies not only in operations, but in our distribution centers. And also consumer facing, that's less things to scroll through on the website. So to me, that is fundamental to get those consumer facing operations facing distribution center facing things in order.

And we did the SKU rationalization with an eye toward what items were duplicate, what has substitutability and what things are just costing us more to hold an inventory than as needed? So there was a good diligence done there.

Under the operations thing, I think that, one of the things that our Chief Operating Officer is doing is going site-to-site not only here in Bowling Green where we manufacture, but we have several manufacturing sites.

And we're getting feedback from the team they're what things are readily available for improvement. And what we're finding is continuous refinement, continuous improvement will build our efficiencies there, as well as cost reductions.

You mentioned mergers and acquisitions. And yes, we have had a lot of them over the past several years. And we're still working through those to find and realize synergies.

Most of them are on our ERP systems, most of them are in our distribution centers. And most of them have centralized back office, things like payroll, but there are other unique things to each business that we are focused on listening to the folks that are running those brands and businesses and making sure that we're optimizing them, both from a marketing standpoint and a manufacturing.

So that brings me to innovation, which you gave us credit for being one of the things that sets us apart. And when we look at our product vitality charts, that's absolutely true. We have improved our innovation process and gave some real clarity to the team that works on that, both the engineering team, as well as the financial team that up, that judges the size of market, the whitespace and where we can make and manufacture things that our enthusiasts will enjoy.

So a really long answer there, but I covered a lot of areas and how we're thinking about prioritizing, and it's kind of like cleaning up the shop and then just cranking out the product innovation. And it's -- there is a sequence to it. So thank you.

John Lawrence

Great, thanks. Just one quick follow-up there, if it's okay, and when you look at capital requirements, obviously, to pay down the debt, does the debt agreements have any covenants or any restrictions on being able to go find a M&A opportunity, if you so choose to?

Jesse Weaver

Yes, thank you for the question. And we do have during the covenant relief period, some limitations on our ability to go make acquisitions. And the focus that we've tried to articulate in our prepared remarks is this year is the year that we tighten the screws and we exit the year at a much, much stronger financial position and operational position.

And so, our intent is to delever the balance sheet, get this business back to what we believe is the long-term potential here, which is over 20% EBITDA margins and to generate strong free cash flow. We know this is what this business is capable of. And nothing has, fundamentally, changed in the market of enthusiasts or our position to prevent us from being able to hit that 40% gross margin and greater than 20% EBITDA. And so, that is the focus this year.

John Lawrence

Great. Thanks, Jesse.

Operator

Thank you. Our next question is from the line of Anna Glaessgen with Jefferies. Please proceed with your questions.

Anna Glaessgen

Hey, good morning. Thanks for taking my questions. Just first, I want to dig into the puts and takes gross margin in 2023. You talked about reengineering some products to widen the chip supply. Can you talk about when that could potentially be flowing into the model, the expected timeline to get there and the potential benefit to the gross margin line?

Michelle Gloeckler

Yes, Anna, it's Michelle, thanks for the question. And when we talk about reengineering the chips, so we mentioned that this was both a product lifecycle and an engineering opportunity. The engineering opportunity to reengineer these products for chips that are more readily available is time consuming.

And we wouldn't expect any of those new products before the end of this year. That said, we are continuing to buy and to put demand out there to try to procure through our distributors as well as on the open market on the existing chips, which are just purely an older model and not as readily available. So I'm glad that you understood there are two efforts going on there, in order to meet the demand for those EFI items.

Anna Glaessgen

Great. Thanks.

Jesse Weaver

So, just to answer your question, as it relates to, whenever you're looking at the economics of our business where the headwind from this is coming from, and I think that the biggest obviously margin is a piece of it, because we do have to purchase the chips that we can find on the spot market, which come at a premium.

But I would say that the bigger opportunity here, long-term, that drives the greatest number of bottom-line dollars is just getting the sales reengaged. And so that's, that is where we are doing everything we can obviously to be financially smart about what we pay on the spot market, but really just getting access to the chips is the number one priority with an eye towards the profitability.

So that we can make sure that our customers that are hungry for our product, actually get the product and are able to stay loyal to the brand.

Anna Glaessgen

Thanks. And then building on that, can you give any perspective on how much unfinished inventory is Holley EFI product that's basically waiting for a chip?

Michelle Gloeckler

Yeah, we haven't shared kind of our past dues. I will tell you that we shared overall numbers around our past dues. And we've made progress on our mechanical product lines. But we still have an amount of past dues in the electronic fuel injection that we're working through. We haven't given a specific number.

Jesse Weaver

Well, and I think I can point you to get you in the ballpark here. We do have in the supplemental materials now a breakdown of those past due buckets between the various categories, electronics, mechanical, exhaust, and so on.

As you'll see there on the electronics bucket, which is the bottom bar of the vast majority of what you see, which is roughly about \$10 million in Q4 is related to these products, which I think to put in perspective and we were talking overall in a normal market, mid-single digits in total sales value.

Anna Glaessgen

Okay, great. Thank you.

Operator

Thank you. If you would like to ask a question today, please press "*", "1" from your telephone keypad and a confirmation tone will indicate your line is in the question queue. You may 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 star keys.

Thank you, and our next question is from the line of Mike Swartz with Truist. Please proceed with your question.

Mike Swartz

Hi, good morning, everyone. I just wanted to ask a question just on this kind of normalization of demand commentary and kind of footing that to the growth, double digit growth you saw in the direct-to-consumer business, throughout the year.

Are we just supposed to expect to read that the normalization demand is really around the reorder--the ordering patterns from distributors and retailers? Because it seems as if the end consumers still strong still buying. So are we, am I reading that correctly? And then has anything changed in the first quarter that's, I guess, changed your view on that?

Matt Rubel

That's a good question. And I think that I'll answer a couple of different ways. As it relates to the first quarter, I mean, I think at this moment, we're not going to be giving any quarterly guidance. But as it relates to your commentary around, I think this question just generally is how is D2C continuing to grow, but you're seeing normalization of demand. And I think is this has become a bigger and bigger part of our business.

Certainly, all of the underpinning business case fundamentals around the D2C getting closer to the consumer, we 100% believe in. And it's something that we are continuing to invest in and certainly see higher gross margin opportunity there.

But the harder thing for us to kind of dig into and understand is really how much of that is incremental versus really channel shifting from either an online retailer, or just another channel that customers may have been getting their products from.

What I can say is, one of the things that's helped us, and I know that we spoke to this in our Q3 call, was just around channel destocking. So, as you can imagine, when it comes to inventory availability, a lot of cases as our resellers might have become a bit more bearish.

And recognizing all the trends that we saw, when it came to consumer shift from goods to services in the back half of the year, we still had product available. And so, as they allow their inventories to decline, it's likely that we picked up some of that benefit, as we have products available for them to purchase.

So, there is that sort of nuance there. And we firmly believe D2C, long-term, is a great additional sort of channel for us. But the incrementality piece of it is really the portion that we are having to dig into.

Mike Swartz

Okay, great. And just as it pertains to the '23 guidance, it looks like you're applying EBITDA margin somewhere in the 17% to 18% range. And I think if we look at kind of the normalization idea, we go back to the '18, '19, you're running in the EBITDA range of 20%, 22%.

I guess, help us understand just the disconnect there, the difference. Are there incremental investments, is that fixed costs deleveraging? Just any way to think about that delta.

Jesse Weaver

Yes. And you're keying in on, I think, part of the reason we provided that additional detail is just to demonstrate this is a business that can be at greater than 20% on the EBITDA line. I think there is a few different things to kind of keep in mind between what the world looked like in 2019 for Holley versus where it is today, that would apply additional pressure on the business.

I would say not the least of which as we have gone public, and there are certainly some incremental costs associated with being public that wouldn't have been in the 2019 numbers.

In addition, while I think we are seeing some really good right-sizing efforts from the work that we have done on the SG&A side to help offset some of those, we're also and we're seeing good work, as it relates to the freight costs.

A lot of the commodity cost increases that have occurred since then are still sort of a burden a bit on the business. And we have initiatives in place, as you would expect. All of our vendors that are commodity driven, were very quick to come and raise prices, but none of them have given us a call back and said, hey, you can actually lower the prices, commodities have come down. So, that's effort that's going to take some time.

And then I would say the last thing is just a bit of an accounting nuance here.

The way our business works when it comes to the inventory valuation and seeing the cost savings that flows through the income statement. A lot of those things actually kind of go on the balance sheet, and you don't get all the benefits immediately, and then they come off the balance sheet. And so, you will see some of that flow through towards the back half of the year.

Mike Swartz

Okay. That's perfect. Thanks for your help, Jesse.

Jesse Weaver

Sure.

Operator

Thank you. Our next question comes from the line of Christian Carlino with JPMorgan. Please proceed with your questions.

Christian Carlino

Hi. Good morning. Thanks for taking my question. As you think about sales for next year, how should we think about the contribution from price versus units and given inflation remains persistent, are you still planning on doing multiple mid-single digit price increases this year, or are you reevaluating that trend?

Michelle Gloeckler

Yes. Thank you for the question. And pricing has been an important lever for us. And it's important for us to be strategic and to understand the industry and remain competitive. So, we will be -- correct, we will be looking, strategically, across our portfolio for pricing.

And as Jesse said in the previous comment, we are continuing to work with our suppliers where commodity costs and other things have come down to make sure that we are buying at the best price, so we don't have to take pricing. But it is always something that we're looking at reflecting ,yet remaining competitive.

Christian Carlino

Got it. And then just double clicking on Jesse's previous answer, is the right way to think about gross margin this year that once you get through 1Q and maybe into 2Q, you will turn through all of the 2022 inventory with the higher capitalized costs. And then you also will benefit from the new freight agreements. So, as you get into the back half, you have this upward inflection for at least those discrete components of the margin?

Jesse Weaver

Yeah, I think what I can do because, again, we won't be giving quarterly guidance, but maybe kind of help you think about the shape of the year a little bit. And we'll just kind of start on the top line because I think that it's important to understand some of the anomalies that we experienced last year, as it relates to the seasonality.

And a lot of this is a bit reading the tea leaves as to kind of what was happening in the economy with the stimulus and whatnot. The Q1 of last year, I think was an extremely strong year. And if you look at historical quarters, this business typically is about 50% to 52%, front end loaded, so Q1, Q2, from a top line perspective, with the balance being in Q3, Q4. And Q2 is generally our strongest quarter in the year. So, I think that's important to keep in mind.

And then as you think about the profitability piece, you definitely see from a year over year perspective, what that implies around sales deleverage in the first half. And then I think coupled with your comments around the cost flowing through, I would say that the team has done a really good job of acting swiftly where possible to go ahead and reap the benefits of the costs identified in the early part of this year.

But certainly, Q1 is going to be a bit of a partial win there, with the back half starting to reap a bit more of those benefits. So, hopefully, that helps you as you kind of get in the ballpark of what we are anticipating for the year.

Christian Carlino

Yeah, that's really helpful. Best of luck, guys.

Michelle Gloeckler

Thank you.

Operator

Thank you. Our next question is from the line of Alex Perry with Bank of America. Please proceed with your questions.

Alex Perry

Hi. Thanks for taking my questions. Just a few, would you say that sort of like there being a demand for Holley EFI is sort of the highest right now out of your entire product portfolio and those are the products that are dealing with the chip shortages? And I guess can you just help us with the impact that's going to have in 2023, and if there is any line of sight of this improving?

I guess is the right way to think about it at the bottom end of the range of the sales guidance imply sort of a 9% decline, 4.5 points of sort of COVID demand normalization and 4.5 points a chip headwind, and then the high end of the range is like 2%, with still that 4.5% of COVID demand normalization and then the highest, it implies the chip availability sort of improves.

Michelle Gloeckler

Yeah, I'll take the first part of that and just thank you for kind of reiterating the guidance, and I want to talk through the demand across our portfolio. We have a really wide portfolio of products across a lot more than just electronic fuel injection. So, when you think about safety, when you think about the mechanical, which we mentioned, is we're in much better conditions supplying that demand. But in exhaust, in brakes, there is, it's a broad portfolio.

And I could go on and on with all my favorite brands. But I will share that EFI, while constrained, we are shipping a portion of our EFI portfolio called Sniper; those chips are readily available. It's a little bit less expensive. The margin isn't as high. There are other items that we have in the EFI portfolio that are strictly for high performance vehicles.

Think about race cars, and they're more expensive, those chips are constrained. Those are the ones we're retooling. But overall, I don't want you to think this is just a huge portion of our portfolio because we have so many other brands and categories.

Jesse Weaver

And then I'll take sort of your question, as it relates to what's implied around the range on the top line guidance. I mean, I would say the two key levers there that get you to the top end and the bottom end, or bottom end are the ones that you identified, which would be the demand normalization.

I mean, I think we have done the work to kind of get us in a range as to what that could be worth. And I think, as you pointed out, the top end of the range would assume probably some combination of less headwinds from that normalization, combined with some improvement in the supply availability that we've been experiencing for the past six months or so.

And then the bottom end would be the reverse of that. So, I think as it relates to what the economic outlook looks like, you talk to five economists, you'll get five different answers, right now in the back half. But I do think that that is a bit of what's the unknown here, as it relates to demand normalization.

And then certainly, as it relates to supply, we don't have any indications at this moment that it's going to get any worse. But I think in the realm of possibility, I don't think that we would have estimated that it would have gotten as bad as it did, either. And so, we have baked that into the top line guide, at this moment.

Alex Perry

Perfect. And then just my follow-up is just to clarify what you said on sort of the phasing of the guidance. It sounded like sort of the first half would be sort of steeper, more pronounced declines. And then we should assume maybe a moderation in the back half. Is the expectation that 2H sales could actually increase, year-over-year?

And then I wanted to ask about sort of DTC and the margin profile there. Is it both higher for you guys on an EBIT margin and gross margins selling through your DTC channel versus wholesale? Thanks.

Michelle Gloeckler

Yeah, I'll take the DTC piece. We have not shared our margin structure there for the direct-to-consumer channel as a comparison to wholesale or other. And the other questions that you had as just to reiterate what Jesse said earlier, Q1 of last year was our strongest quarter of the year.

So, as you're thinking about the flow of the year, I think he answered that, in a typical year, we're a 48%, 52%. And the first quarter last year was our highest growth quarter. So, you should expect to see Q1 with strong overlaps.

Jesse Weaver

Yeah, I think you are, where you imputed and sort of what you had said there is pretty spot on, and I'll just kind of reiterate it. The 50% to 52% first half is more typical seasonality that we see

and Q2 being the strongest, I think that would kind of get you in the range of Q1 would generally be tough from a sales lap, particularly when you combine that with how strong it was last year.

Alex Perry

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

Michelle Gloeckler

Thank you.

Operator

Our next question is from the line of Joe Feldman with Telsey Advisory Group. Please proceed with your questions.

Joe Feldman

Yes. Hey guys. Thanks for taking the question. I wanted to clarify something. Just maybe I just misheard it. But I thought at the beginning, you had said that, with regard to the guidance at the midpoint, the sales would be a headwind of around 5%.

And then you said around 4% to 4.5% of that may be headwind due to the normalization of the industry. But then later, when someone was asking about the microchip headwind, you guys said that was a mid-single digit headwind, which doesn't quite match that if let's say, we're at the 5%. So, can you kind of square those two comments?

Jesse Weaver

I don't recall quantifying, and I apologize if it was read that way for the callers. I don't recall qualifying the mid-single digit headwind related to the supply chain piece. But I think there's-- what we are trying to do is get you guys sort of what we would call the meat of what the guide is and the big drivers, and those are the two big ones.

I mean, we've also got in there if you wanted to kind of dig deeper into. We have got pricing that's a tailwind. We have certainly got a bit of tailwind from some acquired businesses that would be helping us out. But then the other headwind there is, last year, if you just look at our order demand, it certainly wasn't as strong as what the net sales would have implied because we had a good sort of tailwind from burning down the backlog throughout the year.

So, and those things all kind of wash out, but I think the big items that I would recommend the investment community focus on here, or what's happening with the normalization of demand, and our ability to secure these chips to help improve what we see is the midpoint of the guide. Hopefully, that helps to clarify it for you, Joe.

Joe Feldman

That does.

Matt Rubel

Yeah, just one other thing, this is Matt Rubel. I think it was one of the callers who put that number out; it was not something what Jesse or Michelle put out. They framed it in how they asked the questions. So, that's what you might have heard.

Joe Feldman

Okay. Thank you for clarifying guys. I really appreciate that. And then I guess I know, you just, you said this a couple of times now, reading the tea leaves, but when does the industry maybe if not even you guys, but like, according to SEMA, like, are they assuming we get back to a normal level of demand, like in 2024 or is it 2025? Like, what is their forecast to maybe bench--

Matt Rubel

--On the macro--this is Matt, again. One of the things that we've seen with the general trend is that we believe and SEMA has validated this, that there will be that 6%-plus growth in the industry. I think one of the things that we have to go backward to go forward here is that there was still a ton of stimulus that was put into the first quarter of last year.

And so, the first quarter of last year, both for the industry and for us was distorted. And so, I think that's one of the things Jesse has done a good job, Jesse and Michelle have done a good job trying to contextualize here. And so you'll, then you went through some channel adjustments of inventory and some other things that happened, after that demand mitigated.

And so, I think an evening of the demand is what we are kind of trying to get back to on historical levels. So, you should start to see, by the time you get to second half, some of that curve moving more to the norm. And then by the time you hit 2024, you should have anniversaried all the noise and be back in a normal state. That's our perspective.

Joe Feldman

Got it. That's very, very helpful. I appreciate that. Thanks guys. And I have more, but I'll ask them later. Good luck this quarter. Thank you.

Matt Rubel

Thank you, Joe.

Michelle Gloeckler

Thank you.

Operator

Thank you. Our final question is from the line of Glen Prevlín (PH) with GHC Capital. Please proceed with your question.

Glen Prevlín

Yeah, good morning. I had two questions. The first is you had brought in I think a former executive to assess some of the integration, prior acquisitions. Just at a high level, what are you seeing? I know you did a pretty good job with some cost-outs here and that \$30 million you called out. But beyond that, what are you seeing is the opportunity there?

And then secondly, Holley's always been known for its innovation and product, and I'm just curious if there is anything in this coming year that you're excited about or want to talk about?

Michelle Gloeckler

Glen, thank you for the questions. I'll tackle the first one. Yes, you're correct. From our previous conversations, Brian Applegate joined us in Q4 last year as our Interim COO. As you recall, he was the former CEO of Driven and also a former President of SEMA.

So, he knows the industry. He knows the brands and he's an operational wizard. And it's, we are fortunate to have him. And he has been focused on cost savings, acquisition synergies. And as I mentioned earlier, a lot of our acquisitions are already on our ERP system and the distribution center on the website and have the back-office things.

But we are also looking at what things do they do unique that are more efficiently done in their system with their way and their expertise.

So, we continued to work through that and have, while we realized and we did share how much we realized with acquisitions during 2022, we have more to go. I think we put a \$3 million to \$3.5 million range out there for future synergies in 2023.

When you talk about our innovation and product, we have an innovation pipeline, we have an innovation process team, engineering, it's really cross functional, marketing looking at demand and whitespace. But today, I don't have anything to share with you. But in the coming quarters we will have details on new product launches to share.

Glen Previn

Great. Thanks. And there seems like there is a tremendous amount of progress that was made since the last call, so well done. Thank you.

Michelle Gloeckler

Thank you Glen. We appreciate your support.

Operator

Thank you. At this time, we have reached the end of the question-and-answer session. And I'll turn it over to management for closing remarks.

Michelle Gloeckler

We appreciate everyone dialing in today and following along on this journey with Holley, and we look forward to sharing in future calls and are available for meetings following for Q&A. Thanks to those who have already scheduled. Have a great day.

Operator

Thank you. This will conclude today's conference. You may disconnect your lines at this time. Thank you for your participation.