

Holley
First Quarter 2022 Earnings Call
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Presenters

Tom Tomlinson, President and Chief Executive Officer
Dominic Bardos, Chief Financial Officer
Vinny Nimmagadda, EVP Corporate Development
Ross Collins, Investor Relations

Q&A Participants

Anna Glaessgen - Jefferies
Joe Altobello - Raymond James
Mike Swartz - Truist Securities
Ryan Sundby - William Blair
Joe Feldman - Telsey Advisory Group
John Lawrence - Benchmark
Christian Carlino - JP Morgan

Operator

Hello, everyone. And thank you for joining us today for Holley's First Quarter 2022 Earnings Conference Call. As a reminder, all phone participants are in a listen-only mode, but later you will have the opportunity to ask questions. A reminder also, today's meeting is being recorded. And now I'm – for opening remarks and introductions, I am pleased to turn the floor over to investor relations for Holley, Mr. Ross Collins.

Ross Collins

Thank you, Jim. Good morning, everyone. Thank you for taking the time to join us today. On the call with me today are Tom Tomlinson, Chief Executive Officer, Dominic Bardos, Chief Financial Officer, and Vinny Nimmagadda, Executive Vice President of Corporate Development and New Ventures and Holley.

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 a future operating and financial performance at a 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, it 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 a company's recent 10-Q, S-4, and S-1 filings with the Securities and Exchange Commission. The information contained in this call is accurate only as of the date discussed. Investors should not assume that statements will remain relevant and operative at a later time. Holley undertakes no obligation to update any information discussed in this call in the future.

Additionally, we will be discussing certain non-GAAP financial measures. A reconciliation of these items to US GAAP are included in today's press release, which is also posted on our Investor Relations website. At this time, I'd like to turn the call over to Tom Tomlinson, Holley's Chief Executive Officer. Tom?

Tom Tomlinson

Thanks, Ross. Good morning, everyone. And thank you for joining us today. Holley delivered strong first quarter results driven by strength, continued strength and consumer demand. Our net sales grew by 25% in the first quarter with a healthy balance of organic and acquired gross. Sales, excluding the impact of acquisitions, which we refer to as organic sales, increased by \$21.6 million, contributing 13.5% of year over year growth, whereas sales associated with acquisitions contributed \$18.1 million, or 11.3%, of year over year net sales growth.

While supply chain challenges continue to limit our ability to fully satisfy consumer demand, our team performed well, enabling us to capture very nice growth in the quarter despite the challenges. Pricing actions taken in 2021 allowed us to overcome higher freight and product costs and deliver a slightly higher gross margin.

Looking to the balance of 2022, supply chain and inflationary headwinds are very much at the top of our minds. And we remain committed to actively managing these challenges while simultaneously maintaining our focus on developing innovative and exciting new products for our enthusiast consumers. I'll now turn it over to Vinny to discuss Holley's recent M&A activity. Vinny?

Vinny Nimmagadda

Thank you, Tom. And good morning to everyone on the call. As we have discussed on previous calls, M&A remains a pivotal piece of our growth strategy. Our dedicated M&A team continues to manage a robust pipeline of acquisition opportunities, frequently engaging with potential targets in our industry. We are focused on attractive companies that will allow Holley to expand share in current product categories, enter new product categories, increase our DTC scale, and ultimately drive shareholder value.

During the first quarter, sales associated with our 9 recent acquisitions contributed \$18.1 million, or 11.3%, of year over year growth, further highlighting the strength of our platform and the synergies we are able to capture. Not only are these acquisitions accretive to the

business, but they will also provide a more complete business journey and ultimately foster customer loyalty.

As it relates to recent acquisitions, we are well on track to integrate these businesses, realize cost saving synergies, and drive growth. They are also actively exploring opportunities to further accelerate the execution of our integration efforts in order to maximize value creation in the year. With that overview, I'd now like to hand the call over to Dominic who will discuss our financial results in greater detail. Dominic?

Dominic Bardos

Thank you, Vinny. And good morning, everyone. Holley delivered net sales of \$200.1 million in the first quarter, an increase of \$39.7 million, or 24.8%, from the first quarter of 2021. As Tom mentioned earlier, organic sales provided \$21.6 million, or 13.5%, of year over year growth. This organic growth was driven by improved price realization, which contributed \$13.6 million, or 63%, of the total organic growth in the quarter.

The improvement in pricing represented 8.5% year-over-year organic growth by itself. The remaining \$8 million of organic growth came from higher unit sales volume largely driven by strong consumer demand in our electronic fuel injection and safety product categories. Non-comparable sales from acquisitions provide the remaining \$18.1 million of year-over-year sales growth.

Gross Margin increased to 41.3% from 41.0% in the first quarter of 2021. The improvement in gross margin reflects higher price realization that more than offset the significant freight expense increases in the first quarter. You may recall that freight costs rose sharply midyear 2021. And while some moderation in shipping rates has occurred since the peak in the fourth quarter, freight costs still remains elevated in the first quarter and were significantly higher than the first quarter of 2021. We will not lap the significant freight cost increases until the third quarter of this year.

Pricing gains also offset less impactful increases in component costs and product mix. Total selling general and AEM administrative expenses increased 43% in the first quarter. The large increase in SG&A is a continuation of increased costs related to equity compensation, public company expenses, acquisitions and investments for growth. Non-cash equity compensation was \$3 million higher in the first quarter of 2021 and represented 150 basis points of deleverage in the quarter.

Recent acquisitions accounted for \$1.9 million of the increase in SG&A. As a reminder, we anticipate equity compensation and public company expenses to continue to de-lever until we pass the anniversary of becoming a public company in the third quarter of this year. Interest expense decreased by 27% from the first quarter of 2021 to \$7.4 million. Interest expense positively benefited from the \$100 million pay down on our second lien note in July of last year, and the credit facility refinancing we completed in November.

We recorded net income of \$16.9 million in the first quarter of 2022. In 2021, net income was impacted by the recognition of higher earnout contingent liabilities due to the Simpson acquisition. On an adjusted basis, net income increased to \$21.5 million versus \$15.1 million from the first quarter of 2021. Adjusted EBITDA increased to \$46 million in the first quarter, up from \$43.8 million in 2021.

Moving to our outlook for 2022. We are reaffirming the guidance that we laid out in last quarters call. This includes annual net sales in the range of \$765 to \$790 million and adjusted EBITDA between \$186 million and \$194 million. We are also reiterating our CapEx, DNA, and interest expense guidance which are between \$14 million to \$16 million, \$24 million to \$26 million, and \$30 million to \$32 million, respectively.

While it is not our policy to provide quarterly guidance, I believe it's important to recognize that current economic and supply chain headwinds may continue to impact margins in the near term. Also as a reminder, certain SG&A expenses associated with becoming a public company will not be lapped until the back half of the year.

We look forward to delivering our annual targets in 2022. We will continue to navigate these tumultuous times to the best of our abilities, controlling what we can control, engaging with our enthusiast consumers, developing new and innovative products, and making prudent investments to drive long-term, profitable growth for shareholders. That now concludes our prepared remarks. Ross, we can open up the call for questions.

Ross Collins

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

Operator

Certainly. Thank you, gentlemen. And to our phone audience joining today, please press “*” and “1” on your telephone keypad if you would like to ask a question. Pressing “*” and “1” will place your line into a queue. And also a friendly reminder, if you're joining us today on a speakerphone, please return to your handset prior to pressing “*” and “1” to be certain that your signal does reach our equipment. Once again, ladies and gentlemen, that is “*” and “1” if you would like to ask a question. We'll hear first from Anna Glaessgen at Jefferies. Please go ahead.

Anna Glaessgen

Hi. Good morning. Thanks for taking our questions. Appreciate all the color on the pricing impacts and how that helps growth and offset some of the cost headwinds you guys received. Could you help us a little bit more in terms of the magnitude of the headwind from freight? And as we think about the year is, are you assuming this eases as we get to the back half as we last

saw higher costs, just the shape of that headwind, and what's assumed in the guide would be super helpful.

Dominic Bardos

Thanks, Anna. This is Dominic. Yeah, so a couple of things. We haven't really disclosed the exact deleverage of freight. We've just referred to the overall magnitude of increases from containers coming from international shipping and some of the airfreight that we saw. We did see rates start to moderate and come back down from peak container costs, which were north of \$20,000, a container in Q4, back down to the closer to the \$10,000 to \$12,000 per container that we recently saw.

The key for us is that we haven't lapped those freight expenses yet. Q2 is still going to be higher freight costs, and then we start lapping it again. So we haven't really disclosed exactly what the point deleverage is. But it is significant. And pricing is expected to keep managing that.

Anna Glaessgen

Great. And then, as we think about the go-forward pricing opportunity given you have such a high vitality index introducing a lot of products year over year, is it safe to assume that new introductions could continue to offer an uplift to the overall SP?

Dominic Bardos

I'll let Tom jump in on that one. There's a couple of things about it. In some of our major, super popular product lines supply chain is a burden. It is a headwind in terms of getting some of the component increases. Our electronic fuel injection is an extremely popular line right now. And some of our new product development in that space is being slowed because of the headwinds that we have in supply chain.

But new product development is the core of our organic growth driving. We have over 200 individuals now in our R&D and development areas, including our engineers. So we believe that new product development will continue. We are going to continue to make those investments. Even if short term, there are some pressures because that is our long term health.

Anna Glaessgen

Great.

Tom Tomlinson

Also, I would add that we're not reliant on – we're not totally relying on new product introductions to get price. So we've got very strong brands and a history of being able to take price. And we've also been disciplined over the years about doing price increases. So we have additional ability to take price. And as Dominic said very eloquently, I mean, we're continuing to focus on our development efforts, our innovation efforts and constantly bringing new products to market.

Anna Glaessgen

Thanks.

Operator

Next, we'll hear from Joe Altobello at Raymond James.

Joe Altobello

Thanks. Hey, guys. Good morning. Just a quick couple questions for me. I guess first, is there any correlation in terms of fuel prices, gas prices, with the industry in terms of demand?

Tom Tomlinson

So our consumers are enthusiast. And they will make sacrifices to continue to pursue this automotive lifestyle. But at the end of the day, it obviously affects the amount of discretionary income they have left at the end of the week or the pay cycle. And so it is something that we're watching very closely and even where a racer is going to have an event, obviously diesel fuel, for example, being very high affects them as well.

So I mean, I think the really to sum it up, it is something that we're watching. It can have an impact. But compared to other consumers, this is an activity that that people love to engage in. Pretty much part of their lifestyle. And so our consumers also tend to be more affluent than the broader population, which gives them a little more flexibility as well in bad economic times.

Joe Altobello

Okay, that's helpful. And just maybe on supply chain. It sounds like, if anything, it might have gotten worse over the past few weeks. How has it impacted the M&A pipeline? I'm guessing that a lot of you were – smaller competitors are seeing even more issues on that front. So has that actually expand the potential opportunity on the M&A side for you?

Tom Tomlinson

I think at the moment, we really haven't seen that pipeline change dramatically. But with our strong financial position and depending on the severity and the duration of kind of the economic conditions we're seeing, it could very well create an opportunity for us.

Joe Altobello

Okay, got it. Thanks, guys.

Operator

Our next question today comes from Mike Swartz at Truist Securities.

Mike Swartz

Yeah, good morning, guys. Maybe just a follow up on Joe's first question just relating to the correlation between maybe fuel prices and demand. Is there any historical evidence of maybe

looking the other way with a lot of your products actually improving fuel efficiency? Does higher fuel costs play into maybe the interest level on some of these products?

Tom Tomlinson

I really think for our consumers, improving fuel efficiency is a kind of a nice secondary or tertiary benefit. They're really more focused on performance.

Mike Swartz

Okay, thanks for that. And then, just, I think on the prior call you had mentioned, you expect a return to more normal seasonality and 2022, which would imply a larger rate of growth in the back half of the year, but you just had a very nice top line print in the first quarter. You maintained guidance. So are we supposed to be thinking about that maybe a little differently now?

Tom Tomlinson

Well, I mean, our normal seasonality is a higher percentage of our sales occur in the first half of the year.

Dominic Bardos

And there's still a lot of year ahead of us. I mean, Mike, we have, you know, three quarters to go. So, you know, we just don't believe that it's appropriate to change guidance. We have enough confidence in our ability to hit that range that we just don't want to make any adjustments to that at this time.

Mike Swartz

Fair enough. Thank you.

Operator

Ryan Sundby at William Blair, your line is open.

Ryan Sundby

Hey, guys. Yeah. Good morning. Thanks for the question. I guess I'll follow up with another one on consumer demand here. Just wondering if you've saw any changes in demand as you went through the quarter or even here more recently. And then, any color there if you've seen any changes between your DC channels upgrading for for pullback from your retail partners?

Tom Tomlinson

I mean, I will say that direct-to-consumer has continued to be very strong. And we do have the ability for some of our resellers also to look at their out-the-door sales. And so for the quarter, which is the visibility we have, direct-to-consumer has remained strong. And one of the things that we have seen historically is that our resellers, particularly the ones that carry inventory, do have the ability to pull back and reduce their inventory when they become concerned about the economy. And so we did see a little bit of that in the in the quarter.

Dominic Bardos

Yeah, and that's really I think we saw that time with the Russian invasion of Ukraine, which happened at the very end of February. And for us, that was the month of March.

Ryan Sundby

Okay, that makes sense. And then, I think last call you talked about contribution in '21 from acquisitions to be a little more than \$30 million, with acquired growth adding \$18 million here in Q1. Just wondering if you could talk about maybe where they acquired businesses that have outperformed. And then, if you've got maybe an update on what you think what your contribution can be.

Dominic Bardos

Yeah, just as a clarifying point, the contribution of the \$30 million was just four of the acquisitions that we made at the very tail end of the year. There are nine acquisitions that are contributing to the non-comparable growth number, the \$18 million. And that include, for the first quarter, AEM, which was a nice acquisition, we, if you recall, we made in April of last year. So all nine combined will drive the contribution from M&A north of the 30 that we originally discussed.

Ryan Sundby

Thanks. That helps (INAUDIBLE).

Dominic Bardos

Yeah. Thanks for your questions.

Operator

Our next question today comes from Joe Feldman at Telsey Advisory Group.

Joe Feldman

Hey, guys. Good morning. Wanted to ask about inventory and just kind of how you feel about your inventory position today and your ability to meet demand. Are there any areas where you wish you had a little bit more or a little bit less, in some cases?

Tom Tomlinson

Given the given the consumer demand, in the context of the current supply chain challenges, we don't have enough inventory of a lot of our most important products.

Joe Feldman

Got it. I assume you're working hard to improve that situation. I mean, I guess when do you think that would be in a better spot?

Tom Tomlinson

Well, you know, that's the crystal ball. And it's depends on who you listen to. So we're certainly hopeful to see it improve, but we have not seen it improve.

Joe Feldman

Got it. Okay. And then, if I could ask one more. I don't recall, you guys mentioned the DTC business specifically this morning. I was just curious how it performed in the quarter and if you could maybe remind us what percentage of sales it is today.

Dominic Bardos

We haven't released individual quarterly DTC because there is some fluctuation in that. But DTC did outpace our organic growth and continued to do that, just as we saw through 2021. So in 2021, I believe we land at around 17%, Tom. I'm trying to do it off the top my head there. I think it was about 17% of our sales in 2021, 16%, 17%.

Tom Tomlinson

Yeah. Yeah, I think that's pretty close, 16% or 17%.

Joe Feldman

Great. Thanks, guys. Good luck with this quarter.

Tom Tomlinson

And by the way, that's a percent of sales number, not the growth number.

Joe Feldman

Right. Right. Got it. Thank you.

Tom Tomlinson

Right. Okay.

Operator

John Lawrence with Benchmark, your line is open, sir.

John Lawrence

Great. Thanks. Congrats, guys. Could you talk a little bit about the integration plan? Obviously, I guess we're rolling up about a year on AEM. And sort of talk about how that integration plan and has the supply chain affected that plan at all as you tried to integrate these nine companies?

Tom Tomlinson

Supply chain really hasn't had an impact on the integrations. I guess, John, that's the most direct answer to your question. If there's more color there, I'm happy to respond to it.

John Lawrence

Yeah, just the question. Okay. So we started – we're gonna start with AEM. You've had a year, and now some of these other ones. Can you just talk – so it'll be a rolling process as you continue to make acquisitions. I'm just trying to get a sense of where we are, say, for AEM. And is it closer to being eighth or ninth inning of the ball game? Or is it still sixth or seventh inning, to just to get a roadmap of where those where those stand in terms of activity?

Tom Tomlinson

We have made progressive moves at AEM. Our primary focus right now is wrapping up the Simpson integration, which is the largest acquisition that we've done relatively recently, although it's worth saying that we didn't start integrating that for a year, until a year after the acquisition date because of a earn out. I think we've pretty thoroughly discussed that. And so that actually is the priority. We plan to have that done in the second quarter. We would also expect to have AEM finished in the third quarter.

John Lawrence

Great, thanks. Good luck.

Tom Tomlinson

Thanks, John.

Dominic Bardos

Thanks, John.

Operator

And once more, to our phone audience today that is “*” and “1” on your telephone keypad if you would like to ask a question. We'll hear from Christian Carlino at JP Morgan.

Christian Carlino

Hi. Good morning, everybody. Thanks for taking my questions. Just wondering, either this year or in the past, have you noticed any correlation to weather, realizing it would likely just result in a shift of spending to new rather than destruction of demand. But you see that impact in a seasonal auto parts and home improvements. So I'm wondering if you guys see that.

Tom Tomlinson

I would say, historically, we have seen a little bit of that. And it really manifests itself in the form of a delay in the start of the season. So people do get out, they race more, they drive their cars, these lifestyle cars, special interest cars, more in the warmer weather. But generally, we've felt it's been a delay in the season and maybe a little bit of a delay in the spending. But it seems to even out during the course of the year.

Christian Carlino

Gotcha. That's real helpful color. And then, I guess, can you just give us an update on some of the organic investments? The ways to think about is that you're prioritizing the marketing and building the enthusiast site, and you can pick up engineers through M&A. How do you guys think about that and prioritize it?

Tom Tomlinson

Sure. So we actually look at the vehicle platforms, product categories that consumers are most interested in. And we maintain an idea bank of products. And then ,we prioritize them in the context of our strategic plan and assign those projects to our engineers to drive the largest opportunities there from a revenue and profitability standpoint.

We do pick up engineering talent when we acquire businesses. That's one of the things we're always looking for in diligence. And then, one of the things over time is just, we put a lot of effort into accelerating the pace of their new product development. And other investments that we are looking at and have discussed is really to take our digital platform to the next level. And there is ongoing, significant ongoing effort around that.

Christian Carlino

Got it. Thanks for all the color. And congrats on a great quarter. That's all (INAUDIBLE).

Dominic Bardos

Thank you.

Tom Tomlinson

Thank you so much.

Operator

Ladies and gentlemen, we thank you for joining us for this Holley First Quarter 2022 Earnings Conference Call. This does conclude today's meeting, and we thank you all once again. You may now disconnect your lines. And we hope that you enjoy the rest of your day.