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SmartRent.com, Inc.

Second Quarter 2024 Conference Call

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CORPORATE SPEAKERS:

Kristen Lee

SmartRent.com, Inc.; Chief Legal Officer

Daryl Stemm

SmartRent.com, Inc.; Chief Financial Officer, Interim Principal Executive Officer

Frank Martell

SmartRent.com, Inc.; Director and Chair of Operating Committee

PARTICIPANTS:

Ryan Tomasello

KBW; Analyst

Erik Woodring

Morgan Stanley; Analyst

Brett Knoblauch

Cantor Fitzgerald; Analyst

Thomas White

DA Davidson; Analyst

PRESENTATION:

Operator^ Thank you for standing by. (Operator Instructions) At this time I'd like to welcome everyone to the SmartRent Q2 2024 Conference Call. (Operator Instructions)

I would now like to turn the call over to Kristen Lee, Chief Legal Officer.

You may begin.

Kristen Lee^ Hello. And thank you for joining us today. My name is Kristen Lee, Chief Legal Officer for SmartRent.

I'm joined today by Daryl Stemm, CFO and Interim Principal Executive Officer; and Frank Martell Director and Chair of the Operating Committee.

Before the market opened today, we issued an earnings release and filed our 10-Q with the SEC, both of which are available on the Investor Relations section of our website, smartrent.com.

Before I turn the call over to Daryl, I'd like to remind everyone that the discussion today may contain certain forward-looking statements that involve risks and uncertainties.

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Various factors could cause our actual results to be materially different from any future results expressed or implied by such statements.

These factors are discussed in our SEC filings including our annual report on Form 10-K and quarterly reports on Form 10-Q.

We undertake no obligation to provide updates regarding forward-looking statements made during this call and we recommend that all investors review these reports thoroughly before taking a financial position in SmartRent.

Also during today's call we will refer to certain non-GAAP financial measures.

A discussion of these non-GAAP financial measures, along with the reconciliation to the most directly comparable GAAP measure is included in today's earnings release.

We would also like to highlight that a second quarter earnings presentation is available on the Investor Relations section of our website.

And with that, I will turn the call over to Daryl.

Daryl Stemm^ Good morning, everyone. And thank you for joining us today.

Before we delve into our financial performance and strategic updates, I'm honored to introduce Frank Martell our Director and Chair of the Operating Committee.

Frank joined our Board in 2024 and has quickly become a valued member bringing fresh perspectives and experience that will support our company through our leadership transition. His leadership and experience are extremely impactful as we focus on enhancing our opportunities and capitalize on growth opportunities in our dynamic market environment.

Frank's oversight is critical as we discuss today's updates on our leadership and strategic business objectives.

And now I'll turn the call over to Frank.

Frank Martell^ Thank you for the introduction, Daryl. Good morning, everyone.

I appreciate all of you being on the call today.

Before Daryl provides us with an operational update and discuss our second quarter results, I wanted to say a few words about last week's news and the future of SmartRent.

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I recently joined SmartRent as an independent Board Director because I was intrigued and excited by the innovative company that Smart Rent is which is leading in the smart home technology movement and revolutionizing the rental housing industry.

Since joining the Board, it's become very clear to me that this company is a category creator with a unique and leading market position, compelling competitive strengths and exceptional growth opportunities.

Speaking on behalf of our Board, we are as confident as ever in Smart Run's long-term potential and are focused on working with the management team to enhance our operations, provide increased value to our customers and their residents and to drive significant value for shareholders.

Because we are in such a strong competitive position with significant opportunities and because we have such promise on the horizon, the Board believes that now is the time for a change in leadership.

As I'm sure you saw, last Tuesday, we announced that Lucas Haldeman has stepped down as CEO and resigned from the Board.

We commend Lucas on his achievements and thank him for everything that he's done.

As Smart Runs founder, Lucas did an extraordinary job driving innovation and product development, building strong customer relationships and making the company the leader that it is today.

We know that companies see different types of leadership at different stages of its development.

As we evolve and scale smart rent into its next phase of growth, we believe the company will benefit from a CEO with a different skill set and a fresh perspective.

The Board has initiated a comprehensive search for a new CEO who will leave smart rent to the next level as we capitalize on the many compelling opportunities ahead of us.

We formed a management committee of talented SmartRent executives to guide the company in this interim period. The management committee is comprised of the following individuals: Chief Financial Officer, Daryl Stemm, Co-Founder and Chief Technology Officer, IZEA DeRose Wilson, Executive Vice President of Operations, Waran Babis, Executive Vice President of Human Resources, Heather Air; Chief Legal Officer, Kristin Lee, and our Chief Marketing Officer, Robin Young. Darryl will act as our Principal Executive Officer in an interim period. This team is intimately familiar with our business and the industry and has decades of experience in technology services, software, product innovation, real estate and rental housing.

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One of the key reasons we are so confident in Smart Rent's ability to capture the opportunities ahead is that we know we have an exceptional team at the helm.

The Board has also formed an operating committee of independent directors that will oversee the company's operations and work closely with the management committee during this transition period.

While we have a lot of work in front of us, we are confident in Smart Run's future.

From a strong foundation of proven product quality and customer satisfaction, we are finding our organization that we have the tools and infrastructure necessary to enhance our winning value proposition for customers and drive long-term shareholder value.

Finally, I want to thank every member of our dedicated smart rent team who continue to work tirelessly to deliver on our goals and support our customers. Your hard work and commitment are deeply appreciated.

I'll now turn the call back over to Daryl.

Daryl Stemm^ Thank you, Frank. And again, good morning, everyone.

I'm pleased to provide an update on SmartRent's financial performance, and I'm proud of the momentum our team has built to position SmartRent for sustainable growth. This momentum has resulted in three consecutive quarters of positive adjusted EBITDA, reflecting our continued focus on improving profitability.

Additionally, we're steadily driving growth in recurring revenue and enhancing gross margins, providing for greater stability and visibility in this evolving market.

We continue to operate in a challenging economic landscape characterized by shifting capital expenditure patterns influenced by interest rate uncertainties and other macroeconomic factors.

In response to these dynamics, we continue to actively position our company for long-term success.

We're further enhancing our customer engagement. Better understanding and meeting the needs of our customers helps ensure that our products and services align more closely with their expectations. This includes making organizational changes and refining processes within our sales team. These adjustments are designed to improve our accuracy in predicting business trends and customer behaviors.

We're refocusing back on direct sales.

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In 2023, we launched a channel partner sales program designed to leverage external partnerships to extend our reach within our market. Despite the strategic alignment and potential benefits we anticipated the program did not meet our expectations.

In response, we're currently seeking a new sales leader to guide our sales efforts.

Concurrently, we're also enhancing our sales operations organization to refocus and strengthen our direct sales efforts. These strategic adjustments are designed to better align with our core objectives and drive improved sales performance.

Our approach to organic reinvestment prioritizes enhancements to our products, significantly informed by customer and end user feedback. This deliberate focus is directly reflected in our low customer churn and our net revenue retention rate north of 100%, both of which are contributing to increasing our recurring revenue.

Our organic growth approach helps mitigate some of the market uncertainty driving certain customer orders being pushed out from 2024 into 2025.

We're committed to ongoing enhancements to our operating model. This involves continuous improvement across the various aspects of our business. Through back-office enhancements organizational realignment, supply chain optimization and other operating initiatives, we're making incremental gains to bolster both profitability and improved customer satisfaction each quarter. And we continue to implement rigorous cost management. This approach is carefully calibrated to maintain our company's financial health without stripping away the essential capabilities needed for rapid scaling.

We're ensuring that while we manage cost effectively, we retain the agility to capitalize on market opportunities as conditions improve.

At the same time as we are focusing on controlling costs, we continue to prioritize growing recurring revenue streams. Top line recurring revenue growth will help enhance the predictability and stability of our earnings. This shift not only aligns with our long-term operational goals, but also provides our investors with clear visibility. This quarter, we delivered record SaaS annual recurring revenue of \$51.2 million.

This achievement is an affirmation of the trust our customers place in our innovative solutions and the relentless dedication of our team.

Our recurring revenue growth, combined with our operational initiatives has resulted in enhanced per unit economics.

SaaS ARPU this quarter was \$5.63 per unit, which is a 9% increase from last year, which was \$5.16. The -- our ability to drive substantial growth in our SaaS recurring revenue and improve our per unit economics through scale and pricing improvements in the face of broader market

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uncertainties and underscores our commitment to delivering exceptional value and service to the rental housing industry.

Given the continued focus on SaaS growth, we believe returning revenue to be the best indicator of our company's future performance and potential. This focus area underscores our commitment to leveraging our market position and innovation capabilities to deliver long-term value to our shareholders.

We saw a significant 32% year-over-year increase in SaaS revenue, driven primarily by improvements in SaaS ARPU and the number of units deployed.

I'm going to say that again. driven primarily by improvements in SaaS ARPU and the number of units deployed.

These are key metrics that underpin our strategy for delivering more predictable growth.

Over the same period, our SaaS ARR climbed to \$51.2 million, up from \$38.8 million in the second quarter of last year. units booked SaaS ARPU saw a decrease of 8% to \$8.07 per unit from \$8.74 in Q2 2023, primarily attributable to customer and product mix changes.

Turning now to our overall revenue streams. Total revenue for the quarter was \$48.5 million, a 9% decrease from the same quarter last year. Total revenues decreased primarily due to lower units deployed which is primarily a result of the delayed capital investment spending we're seeing within our customer base. To be clear, we're not seeing any change in demand or the overall market opportunity. Rather, we see certain customers that have deferred the deployment of units originally forecast for deployment in 2024 into calendar year 2025. Hosted Services revenue saw a 16% increase to \$18 million from \$15.6 million last year.

Hardware revenue decreased by \$3 million or 11% to \$24.7 million and professional services revenue was \$5.8 million, a decrease of \$4.2 million or 42% from the prior year.

On the deployment front, total units deployed have reached about 772,000 units, an increase of 19% with roughly 121,000 more units compared to the same point last year.

We had a little over 22,000 new units deployed during the quarter compared with approximately \$48,000 in the same period of prior year. Total bookings for the quarter amounted to \$45.5 million, a \$14 million or 44% increase from the same quarter last year.

Gross margin improvements were a highlight this quarter. Total gross margin improved to 35.7% and from 18.5% last year were roughly 1,700 basis points, driven primarily by cost management and improvements to our operating model.

SaaS gross margin improved to 75.5% from 75.1%, a 43 basis point improvement. Total gross profit increased significantly in the second quarter to \$17.3 million from \$9.9 million last year or

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an increase of 75% and Hardware gross profit was \$8.4 million, a 44% increase from \$5.8 million due to product mix. The gross loss in professional services narrowed to \$3 million from \$5.8 million in the same quarter of the previous year, primarily due to reduced volume in units deployed and followed by the benefits of cost management initiatives. Hosted services gross profit increased to \$12 million from \$9.8 million in the same quarter of last year and continues to be the company's most profitable revenue stream.

Operating expenses were \$24.2 million in the quarter including a onetime \$2.3 million impairment charge related to an investment. Compared to \$29.9 million in the same quarter of last year, reflecting our continuance of work on our operating model and cost management. Within the context of achieving a 32% increase in SaaS revenue, these operating expenses demonstrate our commitment to cost management and more importantly, we believe they reflect our ability to effectively leverage our existing cost structure to accelerate revenue growth. Lastly, adjusted EBITDA for the quarter was approximately \$900,000, a 114% improvement from a loss of \$6.4 million in the same quarter from the prior year. This is our third consecutive quarter of positive adjusted EBITDA.

As we conclude the quarter with a cash balance of \$187 million, we remain well positioned to pursue our growth initiatives and navigate the evolving economic landscape and invest in the business.

As communicated last week, we've made the difficult decision to suspend financial guidance. This decision stems from a confluence of factors. Given the ongoing CEO transition, current market conditions, known and anticipated customer capital spending delays and the scaling back of Smart Met's channel partner sales program, we determined it was appropriate to suspend guidance at this time.

In addition, recent internal reviews have highlighted the need to build greater discipline within our sales organization.

In response, the management committee and I are committed to implement more rigorous methods to enhance our forecasting accuracy and reliability.

We intend to reinstate guidance with a clear, comprehensive outlook as soon as visibility into our operations and market conditions improve.

Our commitment is to transparency and precision in our forward-looking statements, ensuring we meet the expectations of our shareholders and paved the way for the company's long-term growth.

Our balance sheet remains strong with substantial cash reserves and no debt which positions us well to capitalize on opportunities and handle potential challenges.

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Our capital allocation strategy is focused primarily on organic reinvestment in high-return projects that strengthen our market position.

Let me also give you a brief update on our existing share repurchase program.

In the quarter, we purchased roughly 765,000 shares and following the close of the quarter, we purchased an additional 842,000 shares. The Board has reaffirmed our existing share repurchase authorization, and we have approximately \$42 million available for future purchases under the program. Going forward, we will opportunistically make purchases in the open market given the substantial disconnect we see between the current share price and the long-term value of the business.

In conclusion, we recognize the uncertain environment in which we operate, especially as delayed capital expenditures among our customers impact the business in the near term. Again, the primary impact of this environment is a delay in anticipated 2024 deployments that our customers have pushed to 2025. The overall long-term opportunity is unchanged and remains extremely compelling. Thank you for your time today.

And now we can open the line and take your questions.

QUESTION & ANSWER:

Operator[^] (Operator Instructions) Our first question comes from the line of Ryan Tomasello with KBW.

Ryan Tomasello[^] Wanted to start by asking about how the WiFi strategy fits into all of the recent developments and changes at the management level. Has the outlook and optimism there changed at all? Obviously 2024 included a step-up in the investment to build out that opportunity.

So curious how the investment plans there might be changing going forward in light of these recent developments?

Daryl Stemm[^] Yes. Thank you, Ryan. The WiFi component remains a very bullish opportunity in our minds, and we've continued to invest in the WiFi program, as you're aware, we have a limited number of WiFi projects that are currently underway, and we did not expect much of an impact from WiFi on 2024 results.

We are, as I said, continuing to invest in the WiFi line.

We might expect that a new CEO who would come in with a fresh perspective might consider some changes.

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But I would say, fundamentally, we believe very strongly in the WiFi opportunity, and it will remain a compelling part of our offering to our customers.

Ryan Tomasello^ Great. And then in terms of these headwinds you're calling out from customers delaying these capital projects, is there a way to quantify the cumulative amount of unit deployments or bookings that you think are being pushed out here out of 2024.

I mean as we think about next year, it seems like there's a high degree of confidence that those deployments and bookings will ultimately come through.

I was hoping you can just put a finer point around the confidence level there? And what you think ultimately needs to play out for apartment operators and your customers over the next, I don't know call it, six to nine months to alleviate some of those headwinds and get these projects back on track.

Daryl Stemm^ We do have a high degree of confidence that these deployments will occur in 2025.

But in terms of what we are looking to see in the macroeconomic conditions, I would say that the persistently high interest rates have had an adverse impact on the acquisition disposition market, in particular. And it may not be directly intuitive, but many of our customers when they're making acquisitions of new communities underwrite technology improvements amongst other improvements into the purchase price.

So the high -- persistently high interest rates have had an impact on our forecast deployment. And that would be the first thing that I would look for, Ryan, to occur between now and the end of this year that would increase our confidence in the actual deployments that are being pushed out to 2025.

Operator^ Our next question comes from the line of Erik Woodring with Morgan Stanley.

Erik Woodring^ I have a few as well. Daryl, maybe if we could just double click on the comment that you just made to Ryan. Again, you say you have a high degree of confidence that what gets put from 24 lands in 2025.

Obviously this is a very dynamic environment, things obviously probably higher probability of shifting relatively rapidly.

So my specific question is, why do you have that confidence?

Is it contractual terms? Is it spending that you see? I'd just love to really understand what leads you to say that you have that high degree of confidence? And then I have a follow-up, please.

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Daryl Stemm^ Yes. The first point that I would make is one that I made to Ryan as well which is, we believe that the likelihood of interest rate softening is more likely than it has been in the past roughly one year. And so I would be looking specifically for a rate reduction as early as September and perhaps multiple decreases to the interest rate between now and the end of the year.

Our customers, we've had discussions with, as you might expect, and we have ongoing discussions with them on a regular basis. and they're expressing a higher degree of confidence in returning to more normalized CapEx investment in 2025.

What's changed over the course of the last half a year to nine months, most recently is that the statements with regards to what might have been deployed in 2024 the customers have said definitively will be pushed out to 2025.

Erik Woodring^ Okay. That's really helpful. And then maybe as a follow-up, Daryl, what I hear from you is a focus on SaaS, on ARPU, on recurring revenue.

I would say, over the last handful of quarters, maybe that messaging was a bit lost with a bit of a focus on hardware, are you suggesting, again, to the degree that you can disclose now before you've gone through any changes and obviously hired a new permanent CEO.

But are you suggesting that there could be maybe a change in the hardware approach and maybe get back to the roots of where SmartRent started, which was less of a focus on hardware and more of a focus on software and connecting the platform together.

Daryl Stemm^ Well our platform is comprehensive. And the hardware and the software are equally important where I think you will see a renewed focus and a return really to our core philosophy is how we're approaching the market.

I repeated the statement about midway through my prepared remarks that the primary drivers behind increasing SaaS revenue are both improvements to the SaaS ARPU and the number of units deployed.

So what I'm really saying there, Erik, point length is we are renewing our focus on deployed units.

Erik Woodring^ Okay. That's very clear. And then maybe just a last one for me. And this would be for anyone on the call just as you think about the next person that you want to bring in to lead this company, what are some of the characteristics? Or what's the type of background that you're looking for in a new CEO?

Is this real estate industry person? Is this a tech, is this an operational person? Just love general comments on what you're looking for in the next leader for SmartRent.

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Daryl Stemm^ Yes.

Well Eric, thank you for the question.

I think what you described would be our uniform applicant to the physician, but a very important point that Frank made and we made in our prior release, is that we've really reached a point where scale, scale is very important.

So one of the primary characteristics that we would be looking for in our next CEO is someone who can bring a history of successful scaling Lucas did a wonderful job of building this company to a \$200 million a year company but the skill set that's required to get a company from \$200 million to, say, \$1 billion is different than the skill set required to get you from 0 to 200.

Operator^ Our next question comes from the line of Brett Knoblauch with Cantor Fitzgerald.

Brett Knoblauch^ If we could start on ARR, it grew nicely sequentially on levered units.

I guess, was it a relatively stronger upsell period? And like what really drove that big sequential improvement in SaaS RP?

Daryl Stemm^ Yes.

You may recall we had a bit of a mathematical anomaly on Q1 actually. And the primary reason for that was that the timing -- the timing of the new deployments in Q1 were relatively late in the quarter. And so we didn't receive -- we can receive anywhere from effectively 0 to three full months of SaaS revenue when we deployed new units in any particular quarter.

So Q1 we deployed more units but received relatively new low amount of revenue.

On top of that, I would point to the bookings SaaS ARPU although the number in Q2 was down from a year ago at \$8.07 per unit it still remains above our existing SaaS ARPU, and it's a clear indicator that as we deploy new units and continue to deploy new units, they'll come on at higher prices, which will incrementally grow the SaaS ARPU from quarter-to-quarter.

Brett Knoblauch^ Got it. That's helpful. Then Secondly, on hosted services gross margins, it stepped back a little bit sequentially. And this is with the hub revenue within that declining by, call it, \$800,000 in the SaaS revenue increasing by \$900,000.

So 75% gross margin went up to 4% of gross margin went down.

I guess how did both services gross margin not go up in the quarter?

Daryl Stemm^ Hosted Services margin was relatively flat during the quarter, it did come down by about 0.3%. And I would say that, that's not necessarily a statistically significant change.

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It is up year-over-year. And I would expect that, generally, it's going to approach 75% breadth over time because the hub amortization portion of it is going down.

During Q2, roughly two-thirds of the total hosted services revenue came from SaaS revenue, which is running at about 75%.

So not overly concerned about the small drop sequentially.

It is up year-over-year from 63% to about 66%.

Brett Knoblauch^ Got it. And then I know you guys are withdrawn guidance, but could you just help frame what you're expecting for the rest of the year? Like -- if we look at deployments in the second quarter, our deployments will be lower in the back half than what we saw in the second quarter. Any insights to how we should think about revenue and profitability over the next six months?

Daryl Stemm^ Yes.

We're not prepared to give any specific guidance at this particular point.

As our visibility improves and as the market macroeconomic climate does change or as we expected to, we would anticipate providing some specific guidance later this year and also around 2025.

Brett Knoblauch^ Okay. And then maybe just lastly, I guess, timing from a new CEO.

I know the search is underway, but is that something we should expect, call it, over the next couple of months before year-end, what's your base case there?

Daryl Stemm^ Yes. Thank you. The Board is working -- presently engaged with a leading executive search firm to identify candidates and also evaluate those candidates and we're really focused on making this a smooth and orderly transition. And we're not setting any particular timeline because of those factors.

We really want to focus on getting the right candidate to lead this company going forward because we believe the long-term value is so very compelling.

Operator^ Our next question comes from the line of Tom White with DA Davidson.

Thomas White^ Two, if I could.

I hope that a little bit late, so apologies if this was covered, but the press release announcing Lupus departure made reference to sort of move away from kind of the channel partner strategy.

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I was hoping you could just maybe provide a little bit more detail about what's happening there, what's prompted that change? Why is that the right move? And then secondarily, Daryl, you mentioned expecting kind of a renewed focus on deployed units.

And I'm curious whether that means also doing that profitably? Or is there a potential that focus on deploying units could see you guys kind of dip back into maybe a little bit of a cash burn period as you prioritize deployed units?

Daryl Stemm^ Thank you for your questions, Tom. With regard to the channel partner program, we're scaling back the program.

We're not totally eliminating the program and one of the primary reasons for putting in place in the first place was really, we feel like it could be an effective way to address the long tail of our market rather than SmartRent it directly engaging -- fully engaging with smaller customers, we think it might be a more economical way to address the lower unit customers.

So we're scaling it back. Last year, it did not work again.

We've got a phenomenal, I think, organic opportunity in front of us in that our existing customers own and operate more than 7 million units.

So what we're really doing is we're refocusing our team to directly sell to these customers so that we can maintain those deep customer relationships and enhance our service to them.

With regards to remaining or profitability on deployment of units, I think that we've actually positioned ourselves very well to be able to expand our unit deployment volumes on a profitable basis.

We've done a lot of investment internally on back office as well as field services and done some realignment of our teams. And I think we've put ourselves in a position where we can expand deployed unit volume profitably. Thank you again, Tom. And thank you all for joining us today.

As we conclude this call I'd like to reiterate a couple of points. Despite the broader economic uncertainty, our solid foundation and strategic foresight have accelerated our innovation path leading to three consecutive quarters of positive adjusted EBITDA while growing SaaS recurring revenue north of 30% and to a record of \$51.2 million. This was accomplished all while keeping operating expenses effectively flat -- and these results speak to the early innings of creating a platform for value creation. The current economic conditions marked by delayed customer CapEx and impact the near-term performance of the business.

But as I stated earlier, the primary impact of this environment is a delay in anticipated 2024 deployments that our customers have pushed to 2025.

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The long-term overall opportunity remains unchanged and remains extremely compelling.

Our commitment to innovation remains strong, informed by customer feedback, which has been instrumental in maintaining our impressive net revenue retention rate north of 100%. And as we move forward, we believe we're well prepared to capitalize on market opportunities and continue to serve our customers and drive long-term value for our shareholders. Thank you all for your time today.

Operator^ This concludes today's call.

You may now disconnect.