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SONOS

Second Quarter Fiscal 2024
Conference Call Remarks
May 7, 2024 - 5:00 pm Eastern/2:00 pm Pacific

James Baglanis, Investor Relations

Good afternoon and welcome to Sonos' second quarter Fiscal 2024 earnings conference call. I am James Baglanis, and with me today are Sonos' CEO, Patrick Spence, CFO Saori Casey and Chief Legal and Strategy Officer, Eddie Lazarus. For those who joined the call early, today's hold music is a sampling from our “Sweets and Spices" station which is curated in collaboration with API@Sonos in recognition of Asian/Pacific American Heritage Month.

Before I hand it over to Patrick, I would like to remind everyone that today's discussion will include forward-looking statements regarding future events and our future financial performance. These statements reflect our views as of today only and should not be considered as representing our views of any subsequent date. These statements are also subject to material risks and uncertainties that could cause actual results to differ materially from expectations reflected in the forward-looking statements. A discussion of these risk factors is fully detailed under the caption “Risk Factors” in our filings with the SEC. During this call, we will also refer to certain non-GAAP financial measures. For information regarding our non-GAAP financials and a reconciliation of GAAP to non-GAAP measures, please refer to today's press release regarding our second quarter Fiscal 2024 results posted to the Investor Relations portion of our website.

As a reminder, the press release, supplemental earnings presentation, and conference call transcript will be available on our investor relations website, investors.sonos.com. I would also like to note that for convenience we have separately posted an investor presentation to our investor relations website, which contains certain portions of our supplemental earnings presentation.

I will now turn the call over to Patrick.

Patrick Spence, Chief Executive Officer

Thank you, James, and hello, everyone.

I'm pleased to report that we did what we set out to do in the first half of our fiscal year, and this performance sets us up nicely to deliver on our previously outlined Fiscal 2024 guidance.

As you've heard from us and others previously, our categories remain under pressure, so our ability to deliver these results is a testament to the strengths of our team, our product portfolio, and our brand. We are holding our own and continue to gain market share in US home theater and streaming audio versus last year.

As you all know, we've been making healthy investments in innovation. Our investments remain focused on two things: the first is attracting new customers to Sonos, and the second is getting our existing customers to add more Sonos products to their life.

There are four things I want to highlight that stem directly from the investments we're making, and how we're laser-focused on attracting new customers and getting existing customers to add more products.

The first is the all new Sonos app. This is our most extensive app redesign and re-architecture yet. Our original app was designed and architected over a decade ago, when Sonos and our customers' needs were very different. We started from the ground up so we can build an app that would deliver our customers a great experience every day, allow us to more easily add new products and categories to it, and move faster with new innovations and features going forward. Our new app brings services, content and system controls to one customizable home screen, creating an unprecedented streaming experience. Best of all, our redesigned app is easier, faster and better. It once again raises the bar for the home music listening experience, and sets up our ability to expand into new categories and experiences.

Our app is a proofpoint of what we have always said: we are the story of software eating audio. Our software truly differentiates our products from everything else on the market, and is key to unlocking the opportunity ahead of us.

Speaking of which, the second is that we are just weeks away from unveiling our newest product. This launch will give us a foothold in a new multi-billion dollar category, expanding the number of categories we play in from 5 to 6 and further diversifying our business. This has been a multi-year investment, and we expect it to pay off in spades in Q3 and beyond. This will also mark the beginning of new efforts on the marketing front to evolve the Sonos brand and reach new audiences.

The third is expanding our distribution footprint. In March we officially went live as a first party seller on Amazon in the US. The partnership is off to a great start, and is a major milestone in our journey to ensure that we attract new customers to Sonos, particularly as we enter new categories. We continue to evaluate our distribution footprint with an eye towards reaching new customers, and look forward to providing further updates in the quarters to come.

And fourth, this quarter we experimented with stimulating additional product sales in our install base by delivering limited time upgrade offers to some of our most loyal, longest tenured customers. We are always exploring how we can better use our unique data and insights to deliver more personalized experiences for our customers. The results of the targeted promotion came in well-ahead of our expectations, validating our ongoing investments in systems to better harness and utilize our data.

Selling both new and existing products into our install base represents a tremendous revenue opportunity. It's what gives us confidence in the success of the product we're about to launch in a new category, and it's what gives us confidence in our ability to scale this business in the years to come. For example, we've previously sized the opportunity of converting all single product households to the average multi-product household to be over $6 billion revenue.

Switching gears, I wanted to briefly touch on our litigation with Google. Just last month in early April, the Federal Circuit affirmed that Google has infringed five foundational Sonos patents. With this ruling in hand, we look forward to pursuing damages for Google's misappropriation of Sonos' innovations.

I want to reiterate that we continue to be laser focused on what we can control.

We are at the onset of a multi-year product cycle as we harvest the benefits of our R&D investments to attract new customers and sell more to our existing customers. It's the flywheel that has powered Sonos for the past twenty years, and we're excited to add some more fuel to the flywheel this year.

We are positioning the company to accelerate our growth while keeping expenses in check to deliver margin expansion in the years to come. The eventual recovery of our categories will only further fuel this reacceleration.

The opportunity ahead remains large, as we have just 2% of the $100 billion global audio market and 9% share of the total households in our core markets. Each year, our business is driven by both the acquisition of new households that enter our install base and by our loyal customers who continue to make subsequent purchases over time.

Our ability to capture a disproportionate share of the opportunity ahead of us will only improve from here.

Great things are happening here at Sonos and the best is yet to come.

I'll now turn it over to Saori to take you through our financials.

Saori Casey, Chief Financial Officer
Thank you, Patrick. Hi everyone.

Since joining Sonos as CFO a quarter ago, I've immersed myself in the details of the business and the exciting product roadmap. I see tremendous opportunity ahead for Sonos to drive sustainable, profitable growth over the long-term and I'm thrilled to be part of the team.

Now on to our results. Q2 revenues came in slightly ahead of our expectations at $252.7 million.

Our better than expected Q2 revenue was driven by strong customer response to some promotions that we ran in the quarter. In particular, we saw great adoption of the targeted promotion to drive upgrade sales that Patrick referenced earlier.

Revenue per product sold was $338, up +11% year over year. This increase resulted from favorable product mix, partially offset by increased promotional activity.

This brings our first half revenue to $866 million, down 11% year over year. Digging in, performance varied significantly on a regional basis. Revenue in the Americas declined 5% year over year, whereas EMEA and APAC declined by 21% and 23%, respectively. Sales in our categories in both EMEA and APAC continue to be impacted by the difficult macroeconomic environment.

Overall, our first half performance puts us in a good position to deliver on our full year guidance.

GAAP gross margin was 44.3%, up 100 bps year over year and roughly in-line with the guidance we gave last quarter. The year over year increase was due to lower component costs and favorable product mix, partially offset by additional promotional activity. Gross margin declined sequentially from our holiday quarter due to the seasonal deleverage from lower revenue in Q2.

Our Q2 performance brings our 1H gross margin to 45.6%, up from 42.7% in the first half of last year. This performance demonstrates the resilience of our underlying gross margins and underpins our confidence that we will meet our fiscal 2024 target of 45-46%.

Adjusted EBITDA was negative $34 million, ahead of our guidance due to higher than expected revenue and lower product and marketing spend. This brings our first half Adjusted EBITDA to $81.6M, representing a margin of 9.4%.

Non-GAAP adjusted operating expenses were $157 million in the quarter, down $22 million sequentially primarily due to a seasonal decrease in sales and marketing spend.

We ended the quarter with $292 million of net cash, which includes $46 million of marketable securities as we deployed some excess cash into short duration treasury bills.

Free cash flow in Q2 was negative $121 million due to typical seasonality, bringing our first half FCF to $148 million compared to $46 million in the first half of last year. This increase was primarily driven by working capital improvements resulting from a focus on better managing our inventory through adjustments to our sourcing plans as well as the implementation of newly adopted payment terms with our suppliers.

Our period end inventory balance was $180 million, down 45% year over year and up just 4% from last quarter. This consists of $114 million of finished goods and $65 million of components. We are working hard to keep inventory balances in check.

And finally, we returned $53 million to our shareholders through stock repurchases in the quarter. We repurchased 2.5% of common shares outstanding as of Q1 at an average price of $17.32 per share. This brings our total year to date share repurchases to $76 million, leaving us with approximately $124 million remaining under our current $200 million share repurchase authorization. We continue to be balanced in our capital allocation strategy and expect to be active in the market repurchasing our stock.

Guidance

Turning to our outlook, we remain confident in our previous guidance for FY24 which I will quickly recap.

Revenue

We expect revenue in the range of $1.6 to $1.7 billion dollars, roughly flat year over year at the midpoint. As previously noted, our guidance assumes that our product in the new, multi-billion dollar category will generate a large portion of the over $100 million revenue we expect from new products this year.

Gross Margin

We expect GAAP gross margins in the range of 45% to 46%, with Non-GAAP gross margins in the range of 45.4% to 46.4% due to approximately $7 million of stock-based comp and amortization of intangibles included in GAAP cost of revenue.

Adjusted EBITDA

Adjusted EBITDA is expected to be in the range of $150 to $180 million, representing a margin of 9.4% to 10.6%.

As previously discussed, we are not providing formal guidance for free cash flow in Fiscal 2024 though we continue to expect to significantly improve our free cash flow conversion versus last year.

Turning to Q3, we expect revenue to grow year over year and be in the range of $375-405 million, which includes a sizable contribution from the launch of our highly anticipated new product. We expect GAAP gross margin to increase sequentially to 45% and 46% primarily due to fixed cost leverage from higher revenue in Q3. Non-GAAP operating expenses are expected to be in the range of $147 to $159 million, resulting in Adjusted EBITDA in the range of $35 to $40 million.

With a solid first half in the books, we are in a good position to deliver on our fiscal 2024 guidance. We are laser focused on execution and accelerating revenue growth in the second half of the year while tightly managing our expenses to drive margin expansion.

With that, I'd like to turn the call over for questions.

Question and Answer Session

Steve Frankel - Rosenblatt

Good afternoon. If I could start with a couple of the new initiatives that happened during the quarter. Maybe give us some feedback on early learnings from the direct presence on Amazon. And any more details you could give us on the installed base promotion and what you might do going forward around that?

Patrick Spence, CEO - Sonos

Yeah. Thanks, Steve. It's Patrick here. On Amazon, we're very pleased with our start there, as I mentioned. Very focused on how we find new customers, and that is something that we've been able to deliver on. Just getting started but something, we think, is going to be even more

important going forward, given some of the new categories that we're going into. So, I think that's been helpful in terms of our overall plan and positioning ourselves for growth.

And then, the – on the installed base, this is one that, as you know well, is a large opportunity for us over time if we can get more of the single player homes to the multi-product average, that's a $6 billion opportunity. And we continue to invest in the systems and the tools to allow us to go after this opportunity even more. And so, we're very excited about the opportunities there. I feel like we're getting well-positioned, particularly through our direct-to-consumer channel, to really tap into that as well, which I think really helps, particularly as we think about as well some of the new products that are coming into play because they're going to help as we tap into our existing base, too.

So, excited about both. I think we have lots of opportunity in both and we're going to continue working on those. And there's other ones we're working on to – again, with that real focus of trying to find other partners that can help us get into new homes. Because as everyone knows, we're only in about 9% of the total homes we think we can address. And so, finding new homes is the name of the game.

Steve Frankel - Rosenblatt
Great. And then, one last question, some characterization of channel inventories, and if you could give us some insight geographically how they may differ as well.

Saori Casey, CFO - Sonos
Yeah. On the channel inventory, we ended with a very comfortable level. We don't usually break it down into the geographic or channel details further on the call. But we're comfortable with where we ended.

Steve Frankel - Rosenblatt
Okay. Great. Thank you. I'll jump back in the queue.

Patrick Spence, CEO - Sonos
Thanks, Steve.

Erik Woodring - Morgan Stanley
Thank you very much for taking the questions, guys. So Patrick, maybe you first, clearly, still banking on a pretty significant product launch in fiscal 3Q. Can you maybe help us understand what you've learned about consumer demand over the last three months? And I say that because we see most consumer companies flagging real caution in kind of the spending environment. Your outlook for this new product has been unwavering. So, can you maybe just help us connect the dots what's driving the confidence as we see maybe some of the macro

outlook, especially as it relates to consumer spending, remain kind of unchanged, negative, maybe deteriorate? Not sure how to characterize it, but maybe you could share some color with us, that'd be helpful. Thank you.

Patrick Spence, CEO - Sonos

You bet, Erik. I'd say for our categories, last three months have been more of the same. And I do wonder if it's our categories have been challenged for a while and maybe I think we had characterized last year kind of being in a pretty weak categories overall. And so, we're not seeing anything that makes us believe it's getting any weaker or any stronger as we go through it. And I think the – so we continue to really focus on what we can control. And I think it's a huge testament to the team, really, the state of our brand and our product portfolio that we've been able to execute across the first half successfully. And so, obviously, we take learnings from that, understanding from that.

I think the other thing is we've done a lot of work to make sure we understand the new category we're going into. It's a large one. So, that gives us confidence. We believe we bring a unique perspective as well. As you might imagine, we've got lots of conversations with channel partners and we also know it's a growing category. So from our perspective, it's a little different than the other categories we're in right now because it is growing year-over-year. And so, all those things combined, plus our ability to execute across the first half, is really what gives us the confidence to keep our guidance for fiscal 2024 intact.

Erik Woodring - Morgan Stanley

Great. And then, I'm not sure if this is for you, Patrick, or for you, Saori, but obviously, a lot going on investment-wise this year, which is great to see. How much of this is kind of run rate operating expenses or investments as we think about the forward look beyond just this year versus how much is a bit of what I would call heavy lifting that you need to do and maybe a bit of pull forward in spend, that some of it potentially doesn't repeat as we look again beyond this year. Can you just help us understand some of that? That'd be really helpful. Thank you so much.

Saori Casey, CFO - Sonos

Thanks, Erik. Certainly, what our investment approach is embedded in our guidance range, the FY 2024 guidance that we've confirmed, we are continuing to invest to optimize for profit growth over the long term, at the same time, making sure that we're optimizing for the future growth as well. So, it is embedded in our guidance and we will share more as we go through the new product launches as we continue to monitor the market. The market continues to be challenging and we realize that we need to stay focused on the market, but at the same time, we will continue to control what we can control.

Erik Woodring - Morgan Stanley
Great

Saori Casey, CFO - Sonos
Thank you

Erik Woodring - Morgan Stanley
Thanks so much for the color, guys. Good luck.

Patrick Spence, CEO - Sonos
Thanks, Erik.

Adam Tindle - Raymond James
Perfect. Good afternoon. I just wanted to start and double click on the promotional focus on getting new homes. Could you just speak to the levers here that you'd be able to pull? Obviously, this is high level. It's early days. But maybe just compare and contrast it to previous partnerships like the IKEA one that weren't as successful in gaining new customers. Thanks.

Patrick Spence, CEO - Sonos
Yeah. So, it's not promo-related. This is more structural and long-term-oriented. So if we're going to add a – any channel partner, it really is about assessing who they're reaching and who they're talking to and how does that fit with today's product portfolio and the one we're building for the future. And so, this is much more strategic in nature in terms of identifying how else do we tap into the 91% of homes that we believe we can address but aren't in yet. And so, that's what's guiding really our push for the expanded distribution that you've seen and will continue to see.

Adam Tindle - Raymond James
Okay. Great. I appreciate the color there. And then, last one from me, I'm hoping you could just dive a little deeper on international trends. Of course, we've seen the weakness, but can you just maybe speak to your market share versus the broader audio segment in those regions? Thanks.

Patrick Spence, CEO - Sonos
You bet. Yeah. So, this is one we watch very closely because we want to know how we're doing relative to the other players that are out there. As I mentioned, the – we continue to, in fact, gain or hold share in the US home theater and the streaming audio, even though those are down year-over-year, which is what we're looking at. Similarly, we're seeing significantly down year-over-year, anniversarying negative year-over-year last year as well across EMEA and then as well into Australia, which is our biggest APAC market at this point. And so, those are ones

where we are holding our own, we feel like. And so, from everything we can see at this point, we continue to hold up well relative to what's happening in the industry more broadly. And I think when you look at our results in terms of the geographies, I think they're very representative of what you're seeing across the industry as opposed to anything Sonos-unique.

Adam Tindle - Raymond James
Awesome. Thanks, Patrick. Appreciate it.

Patrick Spence, CEO - Sonos
Thank you.

Alex Fuhrman - Craig-Hallum
Hey, guys. Thanks for taking my question. Just from a high level, wondering if you can explain to us a little bit, seems like your business today is roughly the same size as it was about three years ago when there was a lot more housing activity, and now, it's been kind of a multi-year slump in housing velocity. Can you talk to us a little bit about what that's done to your customer profile, who you have coming into the brand, how many products they're buying, maybe what their first products they might be buying are? And what steps are you taking to be ready for demand to come back if, presumably, we do see some type of an uptick in the housing market at some point in the future.

Patrick Spence, CEO - Sonos
Yeah. Thanks, Alex. I think the – we've actually been working again in kind of the theme of focusing on what we can control. You recall in Q1, one of the big areas we focused on was bundles and we had our highest proportion of new homes starting with multiple products in that quarter as well. And so, I think if anything, we've shown an ability to try and make sure that we can drive customers because there are so many we haven't tapped into, right, as we think about being only in 9% of those homes, is that if we can put the right kind of packages together for our customers and make it easy for them to buy, as we showed through the holiday season, then I think we can – we, to some degree, are bucking the trends.

Now, overall, obviously, our categories remain under pressure. I think to your point, housing is something that we think would – naturally is a tailwind for us. Ultimately, that's there. And so, I think you prepare for the good times by focusing and getting better in the challenging times on how you execute, how you invest, where you invest and trying to be as creative as possible, so coming up with bundles, looking at how we do promotions to our installed base. All of the things that we're doing today, the innovation we're doing across our product team, the new marketing and brand kind of aspects that we're doing for our new product, all of these things, I think, will benefit us greatly if we get some tailwinds from the categories as well, or housing, if

you will. And so, all of the activities we're doing in this challenging period will pay off when we see the tailwinds come back and the categories pick up. So I think we're doing all the right things we can, and obviously, we'll watch carefully. But we're going to also manage our business appropriately to make sure we navigate these challenging times successfully and do so profitably, as we've outlined many times.

Alex Fuhrman - Craig-Hallum
Great. That's really helpful. Thank you very much, Patrick.

Patrick Spence, CEO - Sonos
Thanks, Alex.

Brent Thill - Jefferies
Hey, Patrick. Thanks. Hey, Patrick, you get the magic wand and you can kind of wave it. What are the things that you think could really help get the environment back to where you'd want to be? What are the two or three things you'd wave that wand over?

Patrick Spence, CEO - Sonos
That's amazing. That's a great question. I mean, I think tailwinds in our category, so people shifting their investments from wherever they happen to be investing today into audio products would be a great thing for us. That would be the biggest thing. I think to Alex' point, like housing is one that certainly we expect to be benefiting from. So, that would be something that would be underlying it. But again, we're not going to – because there are no magic wands, we're not going to focus on that too much, and instead, we're just focused on how do we tap further into that installed base, right, and tap into that $6 billion opportunity, and how do we make sure that we're finding new channels, new countries where we can tap into those homes that we're not in yet. And so, things like expanding distribution, our product innovation pipeline, and then as well, how we deal with our existing installed base and find ways for them to enjoy more Sonos products and tell their friends and family is kind of where we're putting all of our efforts.

Brent Thill, Jefferies
And sorry if I missed this, just on some of the promotional pricing that you put in, I know some of that seemed like it was working, but to what extent are you using that going forward? And do you need to lean on that harder or is that, within that, given your premium product, you don't want to pull that thread, or how do you – how should we think about that?

Saori Casey, CFO - Sonos
Yeah. We continue to look at promotion on – very thoughtfully. Clearly, our goal is to drive for more profitable profit dollars, not just revenue. So certainly, certain markets are very – has

become very promotional and highly competitive. And we're continuing to keep our pulse on the dynamic of the business to make sure we can grow profit to the bottom line.

Brent Thill, Jefferies
Great. Thanks.

Patrick Spence, CEO - Sonos
Thanks, Brent.

CLOSING REMARKS
Patrick Spence, Chief Executive Officer

Thank you. I just want to hit two things in closing:

First, we did what we set out to do in the first half of the fiscal year, and this puts us in a great position to deliver on our Fiscal 2024 guidance.

Second, we are on the cusp of an exciting launch that takes us into a new multi-billion dollar category. We look forward to sharing this new product with the world soon.

And of course, there’s a lot more in the pipeline. Thank you for your time & we look forward to speaking with you again next quarter.