Alarm.com Q1 2017 Earnings Call Transcript

Steve Trundle, President and CEO, Alarm.com

Thanks Jonathan, and thanks to everyone for joining our call today.

We've had a busy quarter, and I am pleased to report that we are off to a solid start for the year. Our SaaS and license revenue in the first quarter grew 26 percent from a year ago to **$50.2 million dollars**. Our adjusted EBITDA in the first quarter was **$14.1 million dollars**, up **30 percent** over last year.

In addition to our solid financial performance, our team continued to execute on initiatives to extend our position as the leading platform for the intelligently connected property. We enhanced and expanded our subscriber solutions. We introduced new tools for our service provider partners that help them operate more efficiently, and increase account retention. And we began to integrate the Connect and Piper business units that we acquired from Icontrol in March.

In early April, we had a strong presence at the International Security Conference & Exposition known as ISC West. This is the largest event in the US for the physical security industry. This year's show included a record number of attendees and exhibitors with increased emphasis on connected devices and cloud services. It's gratifying to see how our innovations have driven the industry in this direction.

ISC West gives us an opportunity to take the pulse of our channel by engaging with a broad cross section of our service provider partners in direct meetings, training sessions and hosted events. We also introduced a couple of new product initiatives that I'd like to highlight.

We demonstrated the way our hardware ecosystem is expanding with new connected devices. For example, we added a new SlimLine edition of our successful video doorbell product. This new form factor will give our service providers more installation flexibility when deploying Alarm.com's integrated perimeter security solution.

We also announced enhancements to our Business Intelligence offering for our service providers. Business Intelligence is a key differentiator for Alarm.com and enables us to better align with the goals of our service providers. Our enterprise-grade analytics solution helps our service providers implement a specific set of installation and service Best Practices that have been proven to increase account retention. Business Intelligence reports allow executives and managers to monitor implementation of the identified Best Practices across the sales, installation and support processes of their business. They can see how branches, teams and individuals are performing, track account installation quality, and identify and address service hot spots so that they can better direct resources to ensure a superior customer experience.

I also want to share some of the market feedback and observations that I took away from ISC West.

First, my conversations with our service provider partners reinforced that we offer the right set of services and have the right go to market strategy. Security-centric services, delivered by professionals, are driving the broad adoption of IoT technology for both homes and businesses. Supported by the Alarm.com platform, our service provider partners are leading the security industry's transformation from traditional alarm monitoring services to broader and more highly valued monitoring and automation solutions. Most service providers are now eagerly adopting new technology instead of resisting change, and our newer offerings generate consistent interest. With these favorable market conditions, we see significant opportunities for continued growth in the North American security channel.

A second take-away is the ongoing proliferation of devices capable of being integrated into an Alarm.com installation. As we deploy fully integrated solutions around otherwise disparate devices, our service providers can extend security, awareness and convenience to more aspects of their customers' home and businesses. We have seen a steady increase in the attachment rate of home automation devices. This includes both third party products and those that we have engineered. For example, we introduced the Alarm.com Smart Thermostat in mid 2015. Many of our service provider partners have trained their technicians to install and support smart thermostats and other automation devices. In the last quarter, the installation rate of our smart thermostat increased more than 30% over the same period in 2016. We expect continued growth as we get into the summer season.

Finally, as the Internet of Things makes more interesting installations and applications attainable, consumers are looking to service providers for a full complement of installation, monitoring and support services. The Alarm.com platform enables our service providers to efficiently deliver the level of service necessary to capture this high-value and growing market segment. Our fully integrated solutions address the needs of these consumers, and our Partner Services capabilities make supporting them more efficient.

Before I turn the call over to Steve Valenzuela, I also want to briefly update you on the integration of the Connect and Piper business units that we acquired from Icontrol in March. Our initial focus has been to ensure that existing Icontrol customers and subscribers receive consistent service. We've now had a few weeks to dig into the businesses we acquired, and we remain excited about the talented people who have progressed through the on-boarding process to join our team. Currently, we are conducting detailed technical reviews of product plans to make sure that we are working together optimally with these new units. We have not encountered any significant surprises and the integration efforts are proceeding as we had anticipated.

To conclude, we are off to a solid start for 2017, and we're looking forward to the year ahead as we continue to execute across a broad set of opportunities. The integration of Connect and Piper is underway, and with our combined Engineering talent, we are excited to be in a position to accelerate the development of market leading solutions for our service provider partners and their customers.

With that, I'll turn the call over to Steve who will review our first quarter 2017 financial results and provide updated guidance for 2017.

Steve Valenzuela, CFO, Alarm.com

Thank you, Steve and Good Afternoon Everyone

I will begin with a review of our first quarter 2017 financial results and then initiate guidance for the second quarter and provide our raised outlook for full year 2017 before opening the call for questions.

We posted solid results across the board to start off the year.

In the first quarter of 2017, SaaS and license revenue grew 26 percent over the same quarter last year to $50.2 million dollars. This includes a partial quarter contribution from Connect following the closing of the acquisition on March 8.

I'd also like to mention that our other segment achieved growth of 121% year-over-year in the first quarter, all be it off a small base.

Our SaaS and license revenue visibility remains high with a revenue renewal rate of 93 percent in the first quarter. As expected, this is slightly below our revenue renewal rate of 94 percent in the fourth quarter of 2016. We indicated on our last conference call that we expected some impact in 2017 from AT&T's 2G sunset program that took effect at the end of 2016. Taking this into consideration, we still expect our revenue renewal rate to stay within our long-term expectation of 92 to 94 percent.

Hardware and other revenue in the first quarter was $24 million dollars, an increase of 26 percent year-over-year. Video camera and video doorbell sales continued to drive growth in hardware. We are pleased to have introduced our new SlimLine edition of our video doorbell this quarter to add to our portfolio of video products.

Total revenue for the first quarter of 2017 increased 26 percent over the same quarter last year to $74.2 million dollars.

Gross margin for our SaaS and license revenue was 84 percent for the first quarter, up about 200 basis points sequentially from the fourth quarter of 2016, and up 100 basis points from the same quarter last year. This is mainly due to the contribution of Connect, which has a higher gross margin percentage than Alarm.com because of a different model.

With Connect, we provide the software and the service provider deploys, manages and operates the software in their own network operations center with their own personnel. The service provider also needs to purchase their own server capacity, network operations bandwidth, and cellular services. With Alarm.com, all the services I just mentioned are managed by Alarm.com on a turnkey basis for the service provider. Like Alarm.com, Connect also charges a monthly per subscriber fee but at a lower amount. Comparing the models from a financial perspective, Connect has a lower per subscriber fee and less costs as the service provider incurs the costs of operating the service. Alarm.com has a higher per subscriber fee to cover the additional cost of services. This results in Alarm.com having a slightly lower gross margin percentage but higher gross margin dollars per subscriber.

Hardware and other gross margin was 23 percent for the first quarter of 2017. This is down about 200 basis points from Q1 2016 due to the larger contribution from video products.

Total gross margin was 64 percent for the first quarter of 2017, up about 200 basis points sequentially from 62 percent in the fourth quarter of 2016. This is mainly due to the higher SaaS and License gross margin in the first quarter of 2017 as I just reviewed.

Turning to operating expenses, R&D expense in the first quarter was $14.5 million dollars or 19.6% of revenue, up from first quarter 2016 R&D expense of $10 million dollars or 17% of revenue. We added 121 employees in the first quarter from the acquisitions of Object Video, Connect and Piper, who are mostly in R&D.

We ended the first quarter with 436 employees in R&D, which represents more than half of our total company headcount of 764 employees.

Sales and marketing expenses in the first quarter were $10.3 million dollars or 13.9 percent of first quarter revenue compared to $9.0 millions dollars or 15.2 percent of revenue in the first quarter of 2016. We expect sales and marketing expense to increase sequentially on an absolute basis in the second quarter of 2017 due largely to our participation at the ISC West conference, as Steve mentioned, that was held in April as in past years.

G&A expenses in the first quarter were $15.4 million dollars. G&A expense includes costs for adjusted measures such as acquisition and integration expenses of $3.6 million dollars and non-ordinary course litigation expense of $1.8 million dollars. Excluding these amounts that are also excluded from adjusted EBITDA, first quarter adjusted G&A expense was $9.9 million dollars or 13.4 percent of revenue compared to $9 million dollars or 15.3 percent of revenue in the same quarter last year.

We held our annual all-employee offsite meeting this year in April whereas last years' event was held in January. The costs for the offsite are mostly accounted for in G&A. This contributed to the higher adjusted G&A expense as a percentage of revenue in the first quarter of 2016 compared to Q1'2017. We therefore expect G&A expenses to be sequentially higher in the second quarter of 2017.

At the offsite, our teams hold meetings over the course of several days to review our plans and align everyone to our company goals.   We were fortunate with the timing of this year's event, as we were able to include our newly added employees from our recent acquisitions.

Non-GAAP Adjusted EBITDA increased to $14.1 million dollars in the first quarter of 2017, up 30 percent from $10.8 million dollars in the same quarter last year.

Given the aforementioned timing of the annual events in the second quarter, we expect just a modest increase in Adjusted EBITDA sequentially in the second quarter from the first quarter of 2017.

GAAP Net income in Q1 2017 was $4 million dollars, up from $2.7 million dollars in the first quarter of 2016.   Non-GAAP adjusted net income was $11 million dollars in the first quarter of 2017, up 80% from Non-GAAP adjusted net income of $6.1 million dollars for the first quarter of 2016.

Turning to our balance sheet, we ended the first quarter with $63.2 million dollars of cash and cash equivalents compared to $140.6 million dollars at the end of 2016. As a reminder, in the first quarter of 2017 we used $87.5 million dollars of our cash and drew $67 million dollars from our bank line to fund the acquisitions of Connect, Piper and Object Video. We ended the quarter with $73.7 million dollars of bank debt.

In the first quarter of 2017, we generated approximately $13 million dollars in cash flow from operations, up from $7.3 million dollars in the same quarter last year. Our free cash flow in the first quarter was $10.3 million dollars, compared to $4.7 million dollars for the first quarter of 2016.

Turning to our financial outlook, we are providing initial guidance for SaaS and License revenue for the second quarter of 2017 of $57.8 to $58.0 million dollars.

For the full year of 2017, we are raising our guidance for SaaS and License revenue to be between $231.7 to $232.7 million dollars, representing year-over-year growth of 34% at the mid-point of this range.

We are also raising our guidance for total revenue for 2017 to $322.7 to $325.7 million dollars. This includes our guidance for hardware and other revenue of $91 to $93 million dollars.

We are also increasing our expectations for Non-GAAP Adjusted EBITDA for 2017 to be between $65.5 to $66.5 million dollars.

We are also raising our guidance for Non-GAAP adjusted net income for 2017 to $36.5 to $37.5 million dollars, or 0.74 to 0.76 cents per diluted share. This is based on an estimate of 49.4 million weighted average diluted shares outstanding.

We expect full year 2017 stock based compensation expense of $5.5 to $6 million dollars.

We adopted the new accounting standard for employee share-based payments, effective with Q1, resulting in a lower tax rate for the first quarter of 12%. We now expect a full year tax rate of approximately 36 percent for 2017.

In summary, we are off to a good start to the year. We are looking forward to the year ahead as we continue to execute on our business strategy and work to integrate our newly acquired teams

With that, Operator please open the call for Q&A.