

Holley, Inc.
Third Quarter 2024 Earnings Results
November 8, 2024

Presenters

Anthony Rozmus, Investor Relations
Matt Stevenson, President and Chief Executive Officer
Jesse Weaver, Chief Financial Officer

Q&A Participants

Christian Carlino - JPMorgan
Mike Swartz - Truist Securities
Joe Altobello - Raymond James
Brian McNamara - Canaccord Genuity
Bret Jordan - Jefferies
Phillip Blee - William Blair
Michael Baker - D.A. Davidson
John Lawrence - The Benchmark Company

Operator

Good morning, ladies and gentlemen, and welcome to the conference call to discuss Holley's Third Quarter 2024 Earnings Results.

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

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And as a reminder, this call is being recorded and will be made available for future playback.

I would now like to introduce your host for today's call, Anthony Rozmus with Investor Relations. Please go ahead.

Anthony Rozmus

Good morning, and welcome to Holley's third quarter 2024 earnings conference call. On the call with me today are President and Chief Executive Officer, Matt Stevenson, and Chief Financial Officer, Jesse Weaver.

This webcast and the presentation materials, including non-GAAP reconciliations, are available on our Investor Relations website. Our discussion today includes forward-looking statements that are based on our best view of the world and of our businesses as we see them today and are subject to risks and uncertainties, including the ones described in our SEC filings.

This morning, we will review our financial results for the third quarter and share our guidance for the fourth quarter and full year 2024. At the conclusion of the prepared remarks, we will open the call up for questions.

With that, I'll turn the call over to CEO, Matt Stevenson.

Matt Stevenson

Thank you, Anthony, and good morning everyone. Today, I am excited to share the progress we've made in Holley's transformation. Your support is crucial as we navigate a consumer environment impacted by persistent inflation concerns. Despite these headwinds, we've made remarkable progress and am eager to highlight our achievements.

Today, we will share more evidence of our transformation, even in a market that often obscures the remarkable work happening within our company. We have built an exceptional leadership team and added talent at various levels, creating a formidable organization poised to drive us towards becoming a multibillion dollar enthusiast platform.

We have, consistently, demonstrated that placing the right leaders in key positions drives significant progress within our business. A prime example is the outstanding work by our digital and consumer experience teams, where our direct-to-consumer business has seen substantial year-over-year growth. This success is driven by our ability to capture market share from other manufacturers through creating engaging consumer experiences, effectively merchandising and promoting our products and leveraging best-in-class digital capabilities.

We are also channeling an equal amount of energy into supporting our loyal distribution partners with the goal of driving their growth in parallel with ours and winning market share by being the best partner. Balancing channels is crucial. We must meet consumers where they prefer to engage in this omnichannel environment.

This includes our distributors, third-party marketplaces, installers, national retailers and our own e-commerce platform. Each of these channels presents opportunities for growth and further coordination.

As we have shown this year, as we build fundamental growth capabilities, we are also maintaining rigorous financial discipline and making meaningful progress on our financial goals.

This includes debt reduction, credit upgrades and maintaining or improving on revenue conversion, even as the market demand has softened. We have made significant strides in

operations this year by eliminating non-value-added costs, allowing us to either reinvest in the business or improve our bottom line.

During this call, we will also share more proof points on the progress of our transformation and highlight more of the innovative products that are hitting the market, across all four of our consumer verticals.

Now, let's touch on some of the key highlights for the third quarter of 2024 on Slide 5. Consumer demand in our industry remains soft as post-pandemic trends favoring experiences and services persist and American consumers tighten their belts due to inflationary costs of household items and essentials. Additionally, economic volatility, higher interest rates and geopolitical uncertainties, including this election year, are weighing on consumer confidence.

Despite this softer market demand, we have successfully maintained our out the door share gains, year-to-date. This is a testament to the power of our brands with consumers, our marketing efforts to support distribution partners and our improved direct-to-consumer marketing capabilities. An example of this is our well executed marketing calendar during the third quarter which, during the event period, resulted in a remarkable 110% lift in our direct-to-consumer sales.

This success was further bolstered by strong B2B participation leading to positive uplift in out the door sales for our participating partners. Our solid out the door performance relative to market demand is being masked in our reported sales this quarter by a couple of critical factors.

First, our major distributors have been normalizing inventory levels, due to lower market demand. Second, our unprecedented ability to fulfill demand, driven by our improved operational performance, has played a meaningful role. Our customers have reported that our lead times are effectively three weeks better year-over-year, allowing them to reduce nearly a month of inventory from the supply chain. The compounding of these two factors impacted our revenue, this past quarter.

However, we consciously partnered with distributors to remove slack from the system, supporting sellout programs to aid them in reducing inventory levels. We are pleased to report the distributor inventories have normalized, which is a positive step towards stabilized revenue, moving forward.

Operationally this quarter, we've continued to make strides achieving a 55% year-over-year reduction in past due. Our cost to serve initiatives launched over a year ago have saved \$2.5 million this quarter and \$6.7 million, year to date. These savings are supporting year-over-year gross margin expansion, which is strengthening our financial position.

We are continually evolving our multichannel approach to consumer engagement. For lifestyle and power brands, our ambition is to deliver unparalleled consumer experiences in every

category. As part of this initiative, we are launching branded experience sites that are significantly boosting engagement and order growth. Plus, our dynamic events are the cornerstone of our engagement strategy and are designed to directly interact with and entertain enthusiasts. We recently concluded our 2024 event season, attracting over 110,000 attendees to various events, nationwide.

Let's turn to Slide 6. That features the quantitative highlights from the third quarter. Net sales decreased 14.4% to \$134 million. Despite the decline in sales, our adjusted gross margins are up 170 basis points, year-over-year, at 39%, again, a testament to our improved operations.

However, with volume coming off due to distributor inventory adjustments, our conversion was affected and EBITDA margins were reduced to 16.5%.

Free cash flow for the quarter was negative \$2.1 million, a decrease of \$23.8 million, compared to the prior year. Again, a combination of factors drove this result, including the lower volume, but also last year at this time we were significantly reducing inventory levels from highly inflated levels in 2022, and that was tying up a lot of liquidity. Plus, recently we implemented a new accounts payable process that delayed some payments in Q2 that we began to catch up with in Q3.

In the third quarter, we initiated the launch of several key products spanning our brand portfolio and our four principal consumer verticals. I will go into more detail regarding some of these notable innovations in an upcoming slide.

As I previously mentioned, the continuous enhancement of our operations is reflected in multiple key performance indicators. By refining our forecasting and demand planning processes, we have achieved a 3.2% increase in the in stock rates of our top 2,500 products, reduced past dues by over 50% and improved inventory turns by 0.3 times, year-over-year.

To further illustrate our connection with enthusiasts, we continue to elevate our efforts to engage with more consumers and promote our fantastic products.

Our LS events continue to gain recognition, and our flagship LS Fest East event had an attendance of approximately 45,000 enthusiasts this year, up meaningfully from last year. Events such as these, coupled with our focused public relations campaigns and relationships with social influencers culminated in generating \$2 million in media value from this event.

Slide 7 offers additional details for those unfamiliar with our famed LS Festival. These events are key to our status as a leading automotive enthusiast platform. LS Fest East, our original event, launched 15 years ago and is a Holley Created & Owned Consumer Event celebrating everything powered by GM's remarkable LS Engine.

This event has been crucial in generating substantial content and forging connections with influencers and media. This year, we achieved 6 million social media impressions, 191,000 engagements, and an influencer reach of 11 million.

This year's event featured participation from over 2,700 vehicles from all our consumer verticals including Domestic Muscle, Modern Truck & Off Road, Euro & Import, and Safety & Racing. LS Fest East continues to be a key driver in the success of Holley, providing a platform to engage with enthusiasts, promote our products and strengthen the presence of our brands. The event's success is a testament to our commitment to creating unique and engaging experiences for the enthusiast.

On the left of Slide 8, we show the three main principles that guide our organization. These principles help us focus on four key areas shown on the right. The first area is our commitment to our team members, ensuring Holley is a great place to work. The second area is engagement with our customers, prioritizing and appreciating all channels including our amazing base of enthusiasts, as well as our distribution partners. We are always exploring ways to expand and enhance our sales channels to engage with a wider group of enthusiasts through an omnichannel approach.

The third area is improving our operations by eliminating non-value-added costs and aligning inventory with market demand. We also aim to provide the best customer experience for both enthusiasts and distribution partners.

Finally, the last key area is optimizing our acquisitions. Holley has acquired several amazing brands and businesses in recent years, and it's important to nurture their unique traits for success.

Slide 9 highlights the progress we made in the third quarter on the keys to unlocking transformative growth. There have been significant strides in developing a high performing team. All key leaders are in place in driving increased professionalism and effectiveness. We executed restructuring to further deepen capabilities within the organization and made numerous strategic hires at the second and third levels of leadership. Also, we conducted a great place to work survey this past quarter and are using the results to elevate our company culture.

Our efforts around digital modernization and consumer experience continue to drive outperformance. Our brand experience sites for key lifestyle and power brands in our portfolio demonstrated approximately 20% of incremental growth in our direct-to-consumer channel for those brands. These sites, along with other improvements in SEO, have significantly improved marketing efficiency through increased organic traffic.

As we already discussed, our well-executed marketing calendar was a great success with direct-to-consumer sales up by 110%, during the event. Additionally, we are spending a lot of time on

our customer and product data, and we recently completed our CRM data consolidation, setting the stage for activations in Q4, as well as finalize our product information management system to serve as a single source of truth of product data for our channels.

In terms of B2B sales capabilities, we on-boarded R&R to support growth among our top 50 B2B partners, including E-Tailers, National Retailers and Wholesale Distributors. R&R is the leading third party sales organization in the automotive performance aftermarket. R&R has been instrumental in driving product data adoption, which will improve the organic growth of existing products.

We have also engaged in joint planning with our top customers to drive partnership and growth. We are developing standardized tracking tools to drive customer level accountability. Our product management and innovation efforts continue to drive progress.

Our product launch groups and phase-gate system have increased new product revenue by 25% this year through better product adoption with distributors. We also formalized B2B product sales training for our Tier 1 products and invested in workflow management tools to enhance efficiency in new launches.

The strategic pricing initiatives we put in place are also yielding positive results. We have automated competitive pricing updates in our top 500 SKUs and are developing good, better best pricing strategies for major categories. We have implemented targeted pricing changes for psychological price points on approximately 1,500 SKUs and are experiencing positive results from that, as well as our 80/20 pricing methodology.

Additionally, MAP enforcement is now in place for over 20,000 SKUs, which is 12 times more than it was just a short time ago. This is key to earning trust with distributors and keeping everyone on a level playing field.

In summary, we are continuing to make progress across all keys to unlocking transformative growth for Holley. And as you will see on Slide 10, we have highlighted some proof points on our transformation, specifically in four areas.

First, our digital and consumer marketing initiatives have delivered direct-to-consumer sales that are up 16%, year-over-year. Additionally, our new standalone brand experience websites are providing over 20% growth in sales.

Second, within our B2B strategy, we are partnering more closely than ever with distributors. Those who have partnered with us on our well executed marketing calendar events have seen a 10% lift in their out-the-door sales. Plus, over the past six months, we have strategically enhanced our national retail channel support team, resulting an impressive 12% year-over-year growth.

Third, our product innovations, new product phase gate system and enhanced execution on product launches have resulted in 133% improvement and revenue per new product launch, year-over-year, driving overall new product revenue up 25%.

Our strategy of organizational changes, innovative products and targeted marketing is driving significant growth in some of our power brands like ADS, Stilo, Dinan, APR and Simpson with some seeing over 30% increase, year-to-date. These points provide tangible evidence that our transformation is working, despite being masked by some of the overall market dynamics I commented on, earlier.

Let's turn our attention to Slide 11, which highlights some of the exciting new products we have launched or are planning to launch across our various consumer verticals. Starting with Domestic Muscle, we have three standout products. First, we have the Sniper 2 EFI bundle with a HyperSpark ignition system. This bundle offers significant retail savings and allows users to turn their iOS or Android device into a self-tuning and monitoring interface, without the need for a laptop.

Next, is the Small Block Chevy Hi-Ram intake manifolds. These manifolds feature a modern race inspired look that complements other EFI and accessory drive products for Small Block Chevy engine applications.

Finally, under the Domestic Muscle vertical, we have the Ford Mid-Mount accessory drive system. Our General Motors LS engine platform solutions contribute significantly to our revenue. Our goal is to simplify engine swaps for enthusiasts, across various platforms. Our new system designed for Small Block Ford engines boosts horsepower with OEM quality and styling in a compact design.

This leaves room for additional upgrades like a turbocharger or supercharger. Our customers have been delighted with our existing LS Mid-Mount solutions. We anticipate the Ford solution will be equally successful.

Moving on to Modern Truck & Off Road which is a large focus of growth for us. We have the Flowmaster Signature Series. This premium exhaust series offers increased performance of up to 21 horsepower and 26 foot pounds of torque on certain applications. A clean, high end look with brushed 304 stainless steel and a lifetime warranty made right here in the USA. This new Flowmaster Signature Series meets consumer demands for high quality offerings lined with the increasing upscale positioning and pricing of full size trucks.

Next, is the Baer BIG Claw. We are really excited about this product, which is focused on all major late model full size pickup platforms. The value proposition here is fantastic, as it enables consumers to swap to bigger brakes using the stock caliper.

Whether you're looking for improved stopping distances because you tow a lot or because you added bigger tires, these brakes will improve stopping distance through performance at a fraction of the cost of a full big brake kit. They are easy to install, require no brake bleeding and have easy to get replacement pads.

Another great product for full and mid-sized trucks is the ADS Mesa shocks. These shocks are available for a wide range of custom and direct fit applications. They enhance handling capabilities, improve ride quality and offer competition inspired performance in an easy to install package, plus they are made in the USA at our Tucson, Arizona, facility.

In the Euro & Import vertical, we have the new Dinan carbon fiber cold air intake for the V8 found in the BMW M550 and 850. The intake offers power gains of 17 horsepower and 18 foot pounds of torque, without any additional modifications.

Next is the APR Catback exhaust system for the very popular Volkswagen Mk8 Golf R. This Catback system improves turbocharger response with peak gains of horsepower and torque at all four wheels. Precision bracketry ensures professional grade installation at any skill level.

Additionally, we have the Dinan performance control unit for late model BMWs equipped with the S58 engine. This unit offers Bluetooth connectivity and control via a free iOS or Android app with five adjustable power levels. It provides peak gains of up to 155 horsepower and 163 foot pounds of torque on select applications.

Finally, in the safety vertical, we have the new Stilo Venti WRX helmets. These helmets, engineered for extreme conditions, offer top performance and protection. With a 34% increase in the field of view, they ensure you never miss a detail.

Next, is the Simpson adventure motorcycle helmet. This exciting new line is targeted at enthusiasts who own Adventure motorcycles. These new helmets offer exciting attributes with a wide range of color options, and this is Simpson's first helmet series in the growing Adventure segment of the motorcycle market, offering a fantastic growth opportunity for their brand.

And last but not least, the Stilo ST6. The ST6 is a successor to the highly successful ST5 and is ready to set new standards in motorsport helmet technology and user experience. This helmet offers improvements in energy management, safety and performance and meets the latest FIA regulation changes. These exciting new products are a testament to our commitment to innovation and excellence. We are confident they will contribute to Holley's growth and success.

Now I'd like to turn the presentation over to Jesse, who will discuss our Q3 results in more detail and the outlook for the remainder of 2024.

Jesse Weaver

Thank you, Matt, and good morning, everyone. Turning to Slide 13, I'd like to begin by providing an update on the progress we've made on our four financial priorities year-to-date, which include restoring historical profitability, improving free cash flow, optimizing working capital and reducing debt.

First, while EBITDA margins were challenged from fixed cost deleverage from lower sales in the quarter, we continue to make excellent progress restoring historic profitability and working towards our long-term goal of 40% gross margin and at least 20% EBITDA margin on an annualized basis.

Our progress was demonstrated in the quarter, as we realized another \$2.5 million from our cost to serve efforts, bringing our year-to-date total to \$6.7 million, surpassing our expectations for Q3. I'm proud of the team's efforts on restoring profitability, over the last two years. Since I joined, the team has been able to achieve over \$33 million in cost savings, which is worth more than 500 basis points in EBITDA margin.

While our free cash flow was down significantly in the quarter, we have delivered strong free cash flow of \$40 million, year-to-date. And after adjusting for the timing impacts related to changes in our accounts payable process, free cash flow would have been roughly \$4 million for the quarter. Free cash flow management is a key organizational focus of our leadership team. And as we discussed during our Q2 call, in anticipation of a potentially challenging back half, we implemented furloughs that generated cost savings of \$1.2 million in the third quarter.

Moving on to our working capital, we once again managed inventories well in the quarter, which is a continuation of the trend we have seen throughout 2024. Inventory held near levels we saw last quarter and was reduced by roughly \$28 million, year-over-year, to \$179 million. Inventory turns also improved to 2.2x at the end of the third quarter in 2024 versus 1.9x a year ago at the end of the third quarter in '23. And has held steady quarter-over-quarter despite a challenging top line, coupled with continued improvement in our in-stock levels on top performing products.

Finally, we are committed to decreasing our debt and strengthening our balance sheet, which was recognized, again, earlier in the quarter by Moody's. Moody's ratings upgraded Holley's corporate family rating to B2 from B3. And overall, I'm proud of this team's efforts on making continuous progress on our financial priorities, even as we operate in this challenging macro environment.

Regarding the macro environment, the September inflation figures increased sequentially but showed a slight decrease from August on a year-over-year basis. What is distinctive about our current position in the economic cycle is that the effects of the COVID stimulus have largely dissipated, leaving consumers experiencing inflation fatigue.

Due to the prolonged and widespread impact of inflation, we observe that all consumer groups are becoming more cautious with their purchases and emphasizing value. Furthermore, it is important to note that not all consumer spending is consistent. There is notable strength in areas such as services and experiences, which continue to outperform spending on discretionary goods.

Historically, an increase in spending on services and experiences comes at the expense of goods spending. Combined with deceleration in wage growth, rising household debt and delinquency expectations reaching their highest levels since April of 2020, pressure remains on discretionary goods spending, adversely affecting our target enthusiasts.

In the performance aftermarket, while our estimates suggest the overall market has declined roughly 4% to 5%, year-to-date, the out-the-door sales of Holley Performance Brands at our distribution partners is only down 3%, suggesting that our partnership efforts with our distribution partners and marketing support is allowing us to gain share, during this time period.

While the market softness had an impact on the overall quarter, the declines in the quarter were magnified by multiple factors that I'll cover in detail in a few slides.

First, let's turn to Slide 14, where we've highlighted some of our key financial metrics for the quarter. Net sales in the third quarter were \$134 million, compared to \$156.5 million in the same period a year ago. While at the low end, this result is in line with the guidance we provided previously. And as I'll discuss further momentarily, this top line headwind was largely the result of distribution partner inventory adjustment and reduced benefits from pass through burn down in the quarter versus the same quarter last year.

Gross margin for the quarter was 39%, up from 37.3%, a year ago. This improvement is due to better freight costs, reduced purchasing price variance, warranty improvements and fewer write-downs from strategic product rationalization. These efforts protected against margin compression on softer sales, resulting in a 170 basis point margin expansion.

SG&A, including R&D expenses for the third quarter, was \$34.7 million versus \$35 million from the prior year. The decrease in SG&A was predominantly driven by the \$1.2 million furlough savings offset by \$1 million of one time advisory cost to execute the strategic transformation initiatives.

Net loss in the third quarter of '24 was \$6.3 million, compared to net income of \$800,000 in the same period a year ago. Adjusted net loss was \$500,000 in third quarter of '24, compared to adjusted net income of \$3.5 million, a year ago.

We also report adjusted non-GAAP results in order to better focus on the operational performance of the company during the period. And despite a continued challenging macro

environment, we were able to deliver adjusted EBITDA in the third quarter of \$22.1 million with adjusted EBITDA margin of 16.5%.

Slide 15 explains the third quarter net sales decline. Several factors contributed to the lower sales, compared to the same period last year. Overall consumer demand affected our distribution partner sales, but our marketing support, distribution efforts and D2C performance provided some meaningful offsets.

However, headwinds from higher sales from rationalized SKUs last year, a one-time sale on an OEM program in '23 reduced tailwinds from past dues and the distribution partner inventory adjustments that Matt discussed earlier in the call led to much lower third quarter sales, this year.

Based on conversations with distribution partners and our own internal analysis, it appears that we are approaching minimum inventory levels at our distribution partners, and our collaborative efforts to drive out-the-door sales are expected to result in a more predictable revenue trend going forward with fewer significant impacts from inventory adjustments.

As shown on Page 16, we've generated \$40 million of free cash flow, year-to-date. After several quarters of delivering strong free cash flow, we experienced slightly negative free cash flow in the third quarter, but after adjusting for \$5.9 million due to an accounts payable process change in the second quarter, we would have generated roughly \$4 million of free cash flow in the third quarter with year-to-date cash flow being unchanged.

Moving to the next slide, we remain dedicated to reducing our leverage. We ended the third quarter with a net leverage ratio of 4.25 times, significantly lower than our 5 times covenant and the 4.89 times in the third quarter of '23, thanks to our execution on our financial priorities. We remain focused on improving our financial health through improvements in business performance.

Last quarter, we spoke about S&P's upgrade to our debt and credit ratings and in August, Moody's also recognized our improved financial position with their ratings upgraded. The recent upgrades from both Moody's and S&P affirm that the strides we've made, operationally, are flowing through to our financial performance and are acknowledged by leading rating agencies.

Now, I'd like to turn to Slide 18 to discuss our outlook for the fourth quarter and the full year. For the full year of '24, we are updating our guidance to align around the lower end of the previous outlook we shared with you, during our Q2 call. This is due to the continued softness in the overall performance aftermarket.

We now expect net sales to be in the range of \$595 million to \$605 million and are modifying our adjusted EBITDA to be in a range of \$115 million to \$120 million. And as noted earlier, we

remain committed to deleverage but, given the revision to the guide, we anticipate year end leverage to be slightly higher than previously discussed and in the range of 4.15 times and 4.35 times by the end of the year, but will remain well below our 5 times covenant.

Our full year net sales and adjusted EBITDA guidance implies fourth quarter guidance ranges of \$133 million to \$143 million for net sales and \$24 million to \$29 million for adjusted EBITDA.

Our transformative efforts have enabled us to gain share even in a challenging environment, where consumers facing inflation fatigue and prioritize discretionary spending on services and experiences. We remain confident in our enthusiast customer base and believe that demand trends will stabilize in the near-term.

As these trends normalize, Holley will be well positioned to leverage growth initiatives within our transformation strategy, while continuing to achieve our financial objectives of maintaining strong margins, generating significant free cash flow and reducing net leverage.

This concludes our prepared remarks. We would now like to open up the line for questions.

Operator

Thank you. Ladies and gentlemen, at this time, you may register your desire to ask a question by pressing “*”, “1” on your phone. Once you’ve been called upon, please make sure you’re not on mute and proceed with your question.

Our first question comes from Christian Carlino with JPMorgan. Please proceed with your question.

Christian Carlino

Hi, good morning. Thanks for taking the question.

Matt Stevenson

Hi. Good morning, Christian.

Christian Carlino

Good morning. Could you speak to your direct and indirect exposure to China and maybe what percentage you’re accomplishing? Are you currently paying tariffs on--from the last round?

Matt Stevenson

Yeah, thanks for the question, Christian. As part of our cost to serve initiative that now is over a year old, we've been focusing on inbound and outbound freight and a big piece of that inbound, of course, is looking at total landed costs, which included tariffs. And so we've been working on resourcing and reducing tariffs now for over a year.

So, we think we're in pretty good shape and we don't see any significant impacts, going forward. And we look forward to seeing how the policies actually get implemented. But right now, we feel like we're in a good direction with the initiatives we've been working on for over a year.

Christian Carlino

Got it. That's helpful, and understanding it's a small channel for you, when you talked about national retailer sales up 12%. And I think some of the bigger parts retailers have talked about discretionary sales being down mid-single-digits, which aligns with your view of the market. So I guess, could you talk about how much of that do you think is increased shelf space and better brand positioning with the retailers versus just expanding the number of doors and boxes that you're selling into?

Matt Stevenson

Yeah, I mean, Christian, we think in the future it will be a significant area of growth for us. The sales cycles there are a little longer but, previously, it was not a focus for this organization to partner with the national retailers. And there's a lot of focus in some of the major ones about positioning differentiation by offering performance parts. So we've seen growth in some of our products there, definitely year-over-year, that are taking share, and we think there's more opportunity to get product placement in some of our key categories.

Christian Carlino

Got it. Thank you very much. Best of luck.

Matt Stevenson

Thank you, Christian.

Operator

Our next questions are from the line of Mike Swartz with Truist Securities. Please proceed with your question.

Mike Swartz

Hey, guys. Good morning. Maybe start just a question on pricing. And I think, Matt, you kind of called out a number of actions you've taken to refine and optimize pricing and put in place a MAP policy or expanded the MAP policy. I guess I'm just trying to understand like what does this all equate to? Is this--is this positive for pricing? Is this a negative for pricing?

Matt Stevenson

No, it's definitely a positive, Mike, and appreciate the question. Pricing is a discipline we've been working on putting into this organization for over the last year. And one of the things relative to MAP policy alignment was the number of SKUs we were monitoring and enforcing was very low, compared to what we're doing now.

As I commented in my prepared remarks, it's up 12x compared to what we were doing before. One of the great benefits of that, it builds confidence in your distribution partners to invest in your brands because they know you're going to hold everybody on a level playing field and people won't be undercutting them in the market.

Mike Swartz

Okay, that's super helpful. I mean, just to follow up on that, is there any way to kind of think about what kind of pricing benefit that is? Is that like a low single-digit, mid-single-digit? I'm just trying to understand like what that actually means?

Matt Stevenson

Yeah, so on that one, that's just more a thing of building trust and aligning the market. Now relative to price materialization, some of the other initiatives we talked about around psychological price points are 80/20 initiatives in really driving the competitive analysis of our Top 500, and now we're on to our Top 2,500 SKUs. Now that is where we're trying to optimize the elasticity sweet spots to drive increased total profitability.

Mike Swartz

Okay, okay. That's helpful. And then just final question for me. I think your cost to serve savings, I think you said was ahead of expectations. You took some furloughs. Is there an updated estimate on some of the savings that I guess you expect this year from the actions you've taken? And are there any opportunities as we look out to 2025 for incremental cost savings?

Jesse Weaver

Sure, Michael, it's Jesse. So for the full year, we've guided to \$5 million to \$10 million at the beginning of the year, and it looks like we're going to be close to \$7 million to \$8 million. So we get another \$1 million or so from cost to serve here in Q4. And the total impact of the furlough activities for the year should, between furlough and 401-K, should be around \$3 million to \$3.5 million with another \$700,000 or so coming in Q4 related to the 401-K, specifically.

Mike Swartz

Okay, great. Thank you.

Operator

Our next questions come from the line of Joe Altobello with Raymond James. Please proceed with your questions.

Joe Altobello

Thanks. Hey guys. Good morning.

Matt Stevenson

Good morning, Joe.

Joe Altobello

Thanks for Slide 15, by the way, very-very helpful, at least for me. But on that point, if I understand you guys correctly and if I'm not, let me know. But it sounds like you're looking for maybe one more quarter of pain here in terms of distributor inventory normalization. We are at pretty low levels. Is it your expectation that that we'll be done with that destocking activity, by year end?

Matt Stevenson

Yeah, Joe, appreciate the question. A large chunk of that slack that we talked about came out in Q3 ,and there might be some residual in Q4. But yes, to your point, by the end of the year we think all the inventories are going to be in line relative to overall market demand and put us in a good shape for '25.

Joe Altobello

Okay, which leads to my next question, I'm not sure if you're going to answer it, but how should we think about '25? Is your base case that sales would be up next year?

Matt Stevenson

I mean, when you look at Q1 of next year, that's when we expect to see organic growth.

Joe Altobello

Starting in Q1, okay.

Jesse Weaver

Yeah, in Q1 it's a little early, Joe, for us to give a full year guide but Q1, when we look at out the door sales, should be a reasonable lap for us to start to see growth, and then we'll give more full year guidance at the end of the year.

Joe Altobello

Okay. Just one last one, if I could. It looks like you sold Detroit Speed. Can you speak to that? And are there other brands that you would look to sell?

Matt Stevenson

Joe, yeah, Detroit Speed, great team down there at Detroit Speed and that really just wasn't core to our business. They do a lot of high end services and builds on cars and the group at QA1, that was just a better fit for that team and that overall business. But we don't see anything else in our portfolio, at this time.

Joe Altobello

Okay, thank you guys.

Matt Stevenson

Thanks, Joe.

Operator

Our next questions are from the line of Brian McNamara with Canaccord Genuity. Please proceed with your questions.

Brian McNamara

Good morning, guys. Thanks for taking the question.

Matt Stevenson

Hey, good morning, Brian.

Brian McNamara

I'm curious how you guys think the election results will impact your business, specifically on the top line. I'm assuming your customer leans a little more rural, a little less urban. Should the removal of uncertainty help?

Matt Stevenson

Yeah, Brian, appreciate that question. We believe so. I mean, I think you touched on it the way our industry is and aligns relative to policies of the elected administration. I think, overall, there was a buzz in the air at SEMA this week after the election results, and we look forward to seeing how that plays out.

Brian McNamara

Great. And then secondly, just if you could comment on kind of what you saw at SEMA this week, it seems like your presence there was more robust in past years; there's definitely a method to the madness. Any color you willing to provide on that?

Matt Stevenson

Yeah, yeah, absolutely, Brian, we were really thrilled with SEMA this year. As you said, our presence was a dramatic change from in years past. We showed all four of our consumer verticals and all our key lifestyle and power brands, and the feedback from our key distributors were just wow. I mean, a lot of distributors we do business today were even somewhat of unaware of the great brands that are under the different verticals within our portfolio.

Personally, I also had the opportunity to meet with a large number of our distributors and they commented on just the change of mindset we've had over the last year, how they're partnering with us to drive growth and how they're seeing our sales out the door better than the market.

So, it was really great feedback and we took away, I think in total, 10 awards, including one distributor of the year award from one of our major customers--or manufacturer of the year from one of our distribution partners. So overall, it was great showing by the team and really proud of the presence we put out there.

Brian McNamara

That's great. I appreciate the color.

Matt Stevenson

Thanks, Brian.

Operator

Our next questions are from the line of Bret Jordan with Jefferies. Please proceed with your questions.

Bret Jordan

Hey, good morning guys.

Matt Stevenson

Good morning, Bret.

Bret Jordan

Could you talk about the sort of street level health of the distributor, the channel, I guess, as far as the independent speed shops and what you're seeing there after they've seen some cyclical pressure for a while? I mean, are we losing store counts at the--on the street, or is it relatively stable?

Matt Stevenson

No, Brett, we're not seeing any notable change there in that number of installers and generally, the industry as a whole, seems to be quite stable and like I said, we met with a number of key distributors across the show and yeah, some of those of course are seeing those year-over-year declines but, generally, the industry is quite optimistic for '25, especially after the election results.

Bret Jordan

And I guess sort of related to that, sort of anything you have on the end consumer trend, as far as the sort of the cadence or sequential health. I think in the prepared remarks you said becoming more cautious. Is that sounding as if things are incrementally more cautious at the consumer level, or are we sort of bouncing on the bottom?

Matt Stevenson

No, I think so, Bret, great question. I would say that the marketing calendar support that we've been giving our distribution partners was very helpful in making sure our out the door sales with our distribution partners in Q3 was relatively stable, relative to the prior quarter. And we suspect if we're able to continue this partnership, which that was one takeaway from SEMA, lots of appreciation from customer discussions on those partnerships. We should continue to maintain and gain share here in Q4 but, obviously, the overall market health will play a role in us achieving any amount of growth in Q4.

Bret Jordan

Okay. And then just the housekeeping. We talked about sort of SKU optimization or rationalization in the last quarters on the low volume product. Could you tell us sort of where we are in cleaning up those low volume SKUs or getting them off the catalog?

Matt Stevenson

Yes, I mean we've only--the only meaningful strategic product SKU rationalization that we've done in the year was at the end of Q1 and that's just a continuation of what we'd started in the prior year, and there's no additional work there to be done.

Now, there will always be just the ongoing pruning, if you will, of the portfolio, but nothing of significance. I think we've got a really good process internally to, one, make sure we launch the right products, invest in R&D where the consumer is and is going. And then throughout the year, we are just continually just taking a look at that portfolio. So there shouldn't be any call outs, going forward.

Bret Jordan

Great, thank you.

Operator

The next questions are from the line of Phillip Blee with William Blair. Please proceed with your questions

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Phillip Blee

Matt, Jesse, good morning.

Matt Stevenson

Good morning, Philip.

Phillip Blee

Sounds like destocking pressure should be largely over and you're seeing positive out the door sales and healthy growth in DTC with a lot of those investments that you made really starting to ramp up. But fourth quarter sales guide still suggests high-single-digit decline at the midpoint. So can you maybe just help us reconcile expectations and whether there's sort of a higher level of conservatism built in, given the uncertain macro backdrop?

Matt Stevenson

No, I would say that Q4 is pretty consistent with the trends we're seeing, the conversations we're having. I would say what's different now as we've gotten better customer intimacy and engagement is, we've got visibility into their out the door sales, and we're aligning sort of expectations on their reorder to those out the door. So, what you're seeing is, I would say a pretty solid 50-50. There may be some upside there as we support them even more this year

with holidays than we did in years past. But I think what makes me feel good about this guide, in particular, is we don't have the looming cliff of a destocking situation that we went through in Q3.

Phillip Blee

Okay, great. Very helpful. And then if we think about the industry reaching a bottom this year and then showing some sort of inflection in early 2025, are there any areas of the business that maybe you have under invested in over the past year or two that we should expect to maybe see less fall through on the initial return to growth? Thank you.

Matt Stevenson

Yeah, thanks, Phillip. No, our focus has been on driving growth in all for consumer verticals and in all facets of our omnichannel approach. So we have four division leaders over each of those verticals focused on driving growth with those lifestyle and power brands. So our goal is to bring them all up in parallel going forward in '25.

Phillip Blee

Awesome. Thank you, guys. Thanks a lot.

Matt Stevenson

Thanks, Phillip.

Operator

Our next question is from the line of Michael Baker with D.A. Davidson. Please proceed with your questions.

Michael Baker

Okay, thanks. So, I guess following up on a couple questions, it sounds like, correct me if I'm wrong, but sell-in should be matching sell-out roughly in the fourth quarter, sort of at steady state. So I guess, how does it get much better in the first quarter? Is that just predicated on macro getting better? Because you said you think you'll grow in the first quarter, which means \$160 million or so versus the last couple quarters here, which will be less than that and inventory sort of steady state, now. So what drives that growth in the first part of next year? Is that just enthusiasm on consumers bottoming, election results, etc.?

Jesse Weaver

Yeah, thanks for the question, Michael. Yes, there's a number of things. So one point you touched on I think is really critical is our goal is to really drive that equilibrium and sell-in and sell-out. And I think our efforts over the last year and building confidence with our distribution partners really getting better information and tailoring our marketing calendar with our events as well as events they have to really drive that balance. And I think we're making some great progress there.

And we talked about there's a bit of residual inventory adjustment that may occur in Q4, but when you look at Q1, which we commented on of 2025, there's a number of things that are setting up. One is all the great work our team has been doing, and I hope you can see that in the proof points that we provided in the deck. But our Q1 last year, you look at those comps, was really soft and that as an industry had a very, very tough Q1.

And just based on all the work we're doing, the outcome of the election and just the general normalization we've now seen in the industry, we think we're set up to drive that growth in the first quarter.

Michael Baker

Okay. A follow up to that is in terms of the marketing events. So it sounds like you did some big ones in the third quarter. What's planned different in the fourth quarter versus fourth quarter a year ago? Or do you have incremental marketing type days that help the third quarter? Do you have those set up for the fourth quarter, as well?

Matt Stevenson

So relative to our marketing calendar, we continue to get better on our execution of it in terms of partnering with distributors, getting more engagement and really tailoring the elasticity of what SKUs we include and what we don't. So in Q4, we're going to run our normal Holley Days, which is a successful program that we've run for many years, but we just remain the fact that we're getting better of how we execute that.

So nothing from our side in the calendar but also, too, we're participating with distributors on some of their key programs to make sure we're moving that sell-in and sell-out in parallel. So nothing significant outside of holidays in the quarter, but a lot of different constructs, as we partner with distributors on some of their smaller programs.

Michael Baker

Okay, that makes sense. If I could ask one more unrelated, I'm intrigued by bringing in or onboarding R&R Marketing. Is that new for you guys using outside sales forces? And if so, how does that impact your margins? I mean, I'm sure they're taking some of the profits, presumably. So, how do we think about that impacting gross margins, going forward?

Matt Stevenson

Yeah, Michael, in fact, a number of our amazing brands in our portfolio actually had a history of being built by R&R. So they're very familiar with our product portfolio. And for us, as much as we have in our portfolio of these amazing brands and product lines and setting up around our four consumer vertical structure, the size of our B2B team was not at a level needed to really drive that growth that we're looking for.

So we partnered with R&R a few months back and we're really optimistic about what we're going to do together. Their combined team has hundreds of years of experience and we think

the growth that they're going to help us drive will offset any investment made in that partnership.

Michael Baker

Okay, thank you.

Jesse Weaver

Thank you.

Operator

The next question is from the line of John Lawrence with The Benchmark Company. Please proceed with your questions.

John Lawrence

Yeah, thanks. Good morning, guys.

Matt Stevenson

Hey, good morning, John.

John Lawrence

Matt, would you comment a little bit on Slide 10? Obviously the metrics for some of the new product development, really strong coming out of the box. Remind us a little bit, if you don't mind, just about that process you put in place several quarters ago, obviously, you've hit the market strong with some exciting products. What is it, the research and development before you make that decision and maybe talk about the highs and lows of maybe some of those, well, products that you talked about?

Matt Stevenson

Yeah, John, thanks for that question. Yeah I mean, the company, the size of our organization, when I came in, really did not have that discipline and structure about what to design, what to build and then, ultimately, how to launch it? So now we put a simple phase gate system in across our organization, across all our major product categories to help the team get the visibility and the urgency around developing the right products. And so, the business cases and then making sure they have the resources through that development process and ensuring that we're accelerating what they're doing and not slowing it down.

One of the other key deficiencies that we're correcting was the product launch process. So we were designing some great products, but there was not an effective process to bring along sales and marketing on both our D2C, as well as our distributor channel to get nearer term adoption.

So that's one of the things we're looking at is making, is what we've executed on and that's what you're seeing in the results there, is the fact that not only are we bringing the right products to market. We're now being able to get better adoption in both our own channel and

that of our distributors by partnering them on various marketing initiatives to get more awareness in the market.

So, it's just prioritizing products that we know are going to have a great value proposition and making sure we're executing it properly in terms of the launch where, previously, it was just an email to the market, now our distribution partners get all the data and product information and pricing 60-days in advance of the launch.

They can order 30-days in advance of the launch to make sure they have it in stock with their customers. So, when we say go to the market, they're ready to go as well. And again, that's just another initiative we've done that's building the trust with their distribution partners to know they can participate in growth with us. And that's where--that's what's driving some of the success you're seeing.

John Lawrence

Right, thanks. Last question is, as you work out those efficiencies, would the development spend ramp up a little bit or sort of stay where it is, as you work out those efficiencies?

Jesse Weaver

I think from a development spend perspective, John, this goes back to making sure that the teams are working on the right things and being efficient now and where they spend their time and what we invest in shouldn't require us to invest more there. But, as we grow and we see more opportunities, we're not going to, be--we will invest if necessary, but I don't think anything changes our long term margin structure of 40% gross margin and 20% EBITDA.

John Lawrence

Thanks, guys. Congrats.

Matt Stevenson

All right, thanks, John.

Operator

Thank you. I'll now pass the call back to Matt for a few closing remarks.

Matt Stevenson

All right, well, thank you, Rob. Slide 21 underscores what we believe there is a compelling investment narrative surrounding Holley. This market, propelled by automotive enthusiasts, extends beyond a mere pastime. It's a passion and it's a way of life for our customers. We command a vast addressable market approaching \$40 billion. Holley is at the forefront of the industry with a collection of storied brands that have a legacy of innovation.

Additionally, our history is marked by successful acquisitions and value creation through strategic integrations. Plus we are presented with a unique opportunity to forge a new digital

frontier that will transform how our consumers and distribution partners engage with their brands providing us with a competitive edge in fostering growth.

When we emerge from this transformation, our commitment is to be delivering stable, organic top line growth of at least 6%, maintaining 40% gross margin targets and greater than 20% adjusted EBITDA margin targets, generating sustainable free cash flow and establishing a platform that facilitates the unlocking of value in strategic acquisitions.

The combination of the allure of our automotive enthusiast marketplace and Holley's distinguished brand portfolio presents an exceptional investment opportunity.

In closing, I wish to express my sincere appreciation to our team members for their dedication to serving our customers daily, to our remarkable consumers who support our brands as well as our distribution partners, many of whom have been integral to our success for decades.

I also want to thank you for your attention today and look forward to providing updates on our progress in subsequent quarters. I want to thank you again, and have a great weekend.

Operator

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