Transcription

Verisure Group Q2 report 2022

24 August 2022

PRESENTATION

Operator

Welcome to the Verisure Group Q2 2022 results presentation. For the first part of this call, all participants will be in a listen-only mode, and afterwards there will be a question-and-answer session. I will now hand over to Austin Lally, the group CEO, and Vincent Litrico, the group CFO. Please go ahead.

Vincent Litrico

Thank you, operator. Good afternoon and welcome to our Q2 2022 results presentation. Participants on this call are our CEO, Austin Lally and myself, Vincent Litrico, the Group CFO. As always, our Q2 2022 earnings report and presentation can be found in the investor section of our corporate website.

Before we start, let's have a quick look at the agenda on page four.

As in previous calls, Austin will share an overview of the key highlights of the quarter. Then, I will walk you through our financial performance, which will be followed by the usual Q&A session.

And with that, I hand over to our CEO, Austin.

Austin Lally

Thank you, Vincent, and good afternoon to all of you joining us today. I hope you have been able to take a break at some point this summer to recharge, and thanks for taking the time again to engage with our business.

Today we will present the Q2 2022 results for the Verisure Group.

I'm very glad to share that we had another strong quarter and first semester, both operationally and financially.

So, let's start with our Q2 top-line results on slide number five. We had 206,000 new installations in the quarter. This was our strongest Q2 ever. We are now proud to protect more than 4.5 million customers. We have added over 500,000 customers to our portfolio in the last 12 months. Our total revenues are up 12% in the quarter as reported. Our portfolio EBITDA was up 15% in the quarter, reaching €420 million. Quarter after quarter, we continue to post all-time high records. Annualised, our portfolio EBITDA is now over €1.65 billion. Total adjusted EBITDA was up 3.5% in the quarter. We view this as very robust and strong financial delivery, especially in the current external environment with uncertainty, inflation, consumer worries around the cost of living and so on.

Let's now move to slide number six. Our customer portfolio has 509,000 more customers than a year ago. We now have a portfolio above 4.5 million customers. This corresponds to a net portfolio annualised growth rate of 12.7%.

Let's now move to slide number seven. As mentioned earlier, it was another very strong quarter on new sales. We added 206,000 new customers to our portfolio. This is our strongest Q2 ever and our second strongest quarter ever on new sales.

It represents a growth of 4% on the new sales in Q2 2021, despite a more difficult environment. This is of course growth on growth.

Let me also comment on CPA. In Q2 our CPA was €1,423. This is indeed up versus last year. +18.5% versus Q2 last year. Vincent will go into this in more detail in his remarks because there is a significant IFRS accounting at play here, but some of the key drivers of this increase remain the same as those we have been talking about in previous calls. Like everyone, we are seeing inflationary pressures across our cost structure, especially on material costs and marketing investment to stimulate demand in a more challenging external environment for consumers. But even with this current higher level of CPA, we are still creating very valuable and attractive customers with a very high lifetime value. Our payback for new customers remains attractive. Investing in these new customers remains a great use of capital. And of course, on CPA overall, we continue to innovate to find more effective and efficient approaches.

We don't give formal forward-looking guidance, but I can say that we remain optimistic about the future. Even in a more difficult external economic environment for consumers, we still see strong continued demand for new sales, as you saw already in Q1 and Q2. Even if some households are under pressure and consider to delay some discretionary purchases, the amount of white space for us remains significant, given that we operate in relatively low-penetration markets with a long runway ahead.

Let's move to attrition performance on slide number eight. Our portfolio once again proved its resilience. We maintained our strong attrition performance. In Q2 2022 we did see a modest uptick in attrition to 6.65%. But this remains low in absolute. We have been below 7% annualised attrition in every quarter for the last eight years. We believe this performance leads not only our industry but subscriber-based consumer services overall. This is also encouraging given the inflationary pressure that many households are feeling today. It shows that professional security remains a high priority for families, even when they have to make other choices. Our solidity also reflects the high-quality customer intake and customer experience.

We obviously monitor attrition performance extremely carefully. We will always act to protect our customer base. We will continue working hard to maintain the trust and loyalty of our customers who are so valuable and so important to us.

Value creation is not just about the total portfolio aggregated and blended; we also pay strict attention to the profitability of individual customers. These are the foundations of value creation. So, we are now going to look at earnings per customer, EPC, on slide number nine.

In Q2, we continued to enjoy excellent EPC. We reached €31.4 per customer per month. That's up 1.5% versus last year. It's our strongest Q2 performance ever.

Average revenue per user increased to €43.5 per customer per month in Q2, up 2.4% versus the same period last year. This, together with the portfolio growth discussed before, translated into incremental total portfolio revenue of almost €80 million in the quarter compared to the same period last year, representing a year-on-year growth of 15.7%.

We enjoy strong unit economics. Taking a longer-term view over the past five years, we have grown EPC by more than €5 per month, and this was broad based. Unit customer profitability improved in all our main geographies.

With this, I would like to hand back to Vincent, our CFO, who will take you through the financial performance in more detail, and I will come back later for the usual Q&A session and for some final closing remarks. So, Vincent, over to you.

Vincent Litrico

Thank you, Austin. Turning now to slide number ten, you will find our key financial metrics for the quarter.

Verisure Group delivered another strong quarter of financial results. Revenues increased to €698 million in the quarter, representing an increase of 12% versus last year.

Our key cash generation measure, Portfolio Services EBITDA, continued to increase at strong rates and reached a new record high of €420 million in the quarter, an improvement of 15% versus last year. Our annualised portfolio EBITDA is now over €1.65 billion.

We continue to enjoy sustained high profitability levels in our portfolio. Portfolio EBITDA margin was 72.2% in the quarter. The slight decrease in Q2 is still largely driven by the normalisation of portfolio service workloads, post-COVID, as well as some inflationary pressures which we had commented in prior calls. All else equal, we estimate this workload factor impacted RMC, or recurring cost to serve our portfolio, by about €0.20 versus a year ago, representing about 45 basis points of the margin impact. If you look at it over time, we've improved our Q2 portfolio EBITDA margin by almost one full percentage point every year on average during the last five years.

Total adjusted EBITDA was €267 million in the quarter, representing an increase of 4% versus the same period last year.

Cash flow from operating activities generated €216 million in the quarter compared to €187 million in the same period last year. This represents an increase of 16%. This is a combination of slightly higher cash flow generation before changes in working capital, as well as better performance of working capital items.

Total capital expenditures increased 15% versus last year, reaching €213 million in the quarter.

As of the end of the quarter, net debt reached €7.287 million, which is an increase of 4% versus last year.

Finally, we have €371 million of financial headroom from a combination of cash on balance and available funds under our revolver credit facility.

In summary, we've had a continued strong performance financially in the quarter.

Now turning to slide number 11, we show a more detailed income statement for the quarter. Starting with reported financials excluding separately disclosed items, revenue stood at €698 million and total EBITDA at €276 million, what translates into a total EBITDA margin of 40%.

Depreciation and amortisation amounted to €119 million. This relates primarily to the depreciation of the alarm equipment installed at our customers' premises, as well as the depreciation of capitalised variable sales costs. Retirements of assets decreased to €20 million from €35 million last year. This represents the remaining balance of capitalised material and direct costs at the time customers leave the portfolio or upgrade to a new platform.

Operating profit closed at €137 million, which translates into an operating profit margin of 20%.

Net interest expense amounted to €75 million, in line with last year, and other financial items amounted to €1 million.

In total, results before taxes reached 61 million in the quarter.

And now let me quickly cover the separately disposed items. Starting at the top, we incurred €9 million of operating SDI expenses. These are mainly related to ongoing transformational projects. Furthermore, we recorded €18 million of amortisation of acquisition-related intangibles. Most of it relates to the amortisation of the contract portfolio acquired back in 2011 from the Securitas Direct Group. The amount is significantly lower than what we had in previous quarters, as part of the contract portfolios were fully amortised in Q3 last year. This amount is obviously non-cash.

Separately disclosed other financial items reached -€17 million in the quarter. Key drivers are a negative non-cash FX revaluation of debt items and unrealised derivatives of -€13 million, the amortisation of prepaid financing fees of -€3 million, and a negative IFRS 9 adjustment related to the modification of loan agreements of -€1 million.

Finally, if we now look at the reported numbers on the right-hand side of the table, we see that income tax for the quarter was €20 million.

So, all in all, this results in a reported net loss for the quarter of €3 million compared to a €2 million net gain in the same period last year.

Let's now turn to page number 12 where we show an overview of our operating cash flow in the quarter. We had a strong operating cash flow generation of €216 million in Q2, which represents an increase of 16% versus the same period last year. Excluding changes in working capital, operating cash flow generation was €248 million, up 1% versus Q2 2021.

Our main source of cash flow generation is the recurring cash flows from our customer portfolio, which grows month after month, and which currently stands at 4.5 million customers. We generated, as mentioned before, €420 million of portfolio EBITDA during the quarter.

As you know, even though our customers remain with us about 15 years on average, we do not fully capitalise all the upfront investments to acquire new customers. Part of the upfront investment is expensed directly and accounted for in EBITDA, and such effect was €144 million in Q2 2022.

Changes in working capital negatively impacted operating cash flow by €32 million in the quarter. This was mainly driven by seasonal inventory build-ups and increases in trade receivables, partly offset by decreases in other receivables and increases in other payables.

Finally, paid taxes accounted for €19 million and SDIs and other items further contributed to an €8 million cash outflow in the quarter.

Now turning to slide number 13, we illustrate our year-to-date net debt bridge.

Building on our net debt position as of December 21, we generated €465 million of operating cash flow during the first six months of the year. Of that, we decided to reinvest €399 million in additional growth for the company. This mainly includes capital expenditures to acquire new customers, as well as investments in product development, upgrades, and IT infrastructure.

Net interest payments totalled €144 million, and bank advisory and other financial items totalled an additional €9 million outflow.

Finally, we also had an increase of lease liability debt of €9 million, and other negative cash flow effects totalling €18 million.

So, all in all, net debt increased to €7.287 million as of June close, with total leverage decreasing to 6.4x driven by our higher EBITDA.

Turning now to the next page, number 14, we illustrate our quarterly leverage evolution since 2018. As you know, we've de-levered and levered up on several occasions in the last years.

We talked in past calls about how Covid-19 impacted our operations and working capital, and we estimated these impacts to illustrate what our normalised total net leverage would have looked like. As a reminder, on the back of the Q1 2021 big refinancing and subsequent paid distribution, our total net leverage increased to 6.6x. If we normalise leverage for Covid-19 effects, we estimate total net leverage would have been 6.9x. We estimate we de-levered the business by 0.5x like-for-like during the first three quarters of 2021.

In Q4 2021, leverage increased 0.2x driven by the payment to the NCA in December last year, as well as intentional increases in inventory levels to face the continuous supply challenges and manage the equipment phase-in phase-out associated with the transition to our "Moonshot" new technology platform. This working capital trend continued in Q1 2022, which was compounded by some inflationary pressures, especially on material costs.

In Q2 2022, however, we have de-levered the business by over 0.2x, landing at a total net leverage of 6.4x and a senior secured net leverage of 5.1x.

Now, as we always do, I will close the presentation with a quick review of the development of our key metrics over the past years.

In slide 15, we illustrate an overview of our resilient track record of successfully delivering strong, high-quality growth, both top and bottom line every year, irrespective of the external environment.

Starting with the sales engine at the top left-hand side, we've had very strong growth in new customer intake over the years. Over the last four or five years, new installations have grown at a CAGR of 16%. As explained, customer intake grew 6% in H2 2022 versus last year. To put it in perspective, this represents an 11% CAGR since 2019, the last pre-pandemic year. And please note, this is, of course, growth on growth.

In parallel, we have a continued focus on improving customer experience and bringing attrition down to below 7% from an already low industry-leading level.

Strong customer intake and low attrition leads to strong portfolio growth. We've enjoyed double-digit growth in our customer portfolio for several years and we now have over 4.5 million happy customers. It is remarkable that during the last 12 months we've increased our portfolio by over 500,000 customers. And at the same time, this volume growth is complemented by a continuous improvement in unit economic and profitability by customer, or EPC.

Improved EPC is the result of our ability to earn higher pricing, historically above local inflation, and driven by strong product and service innovation, as well as improved efficiency and cost to serve, supported by operating leverage.

As explained last quarter, on average, we've historically been able to price significantly over local inflation. Our pricing window typically occurs in Q1 every year. We decide price increases considering latest available inflation estimates, among other things. Of course, we can be surprised by actual realised inflation in a particular year or quarter. But if this happens, we've demonstrated we're able to catch up in subsequent years.

EPC has grown at a CAGR of 4.5% between 2016 and 2021. H1 2022 EPC growth stood at 1.7%. Growth deceleration is mainly due to the post-COVID normalisation of workloads as well as the inflationary pressures we've been discussing in the last couple of earnings calls.

Overall, strong portfolio growth and continued improvement in unit economics has led to consistent high double-digit growth in our key profit and cash flow measure, portfolio EBITDA. And as mentioned before, portfolio EBITDA is now over €1.65 billion on an annualised basis.

And with this, we conclude this part of the presentation. I would like to hand the mic over to the operator for the Q&A session.

Q&A

Operator

Thank you. If you have a question for the speakers, please press 01 on your telephone keypads and you will enter a queue. After you are announced, please ask your question.

Our first question comes from the line of Vivek Khanna of Deutsche Bank. Please go ahead.

Vivek Khanna

Hi. Good afternoon, everyone and thank you for the presentation. I had a couple of questions really focused on subscriber acquisition and then the impact of inflation. So, at first CPA was up sequentially, but then if you compare it to the first nine months of last year, it's clearly up quite a lot more. Could you maybe give us a little bit of colour as to what's driving that? How much of that increase is – and I appreciate some of that's capitalised, some of that's OpEx – but just looking at that sort of investment bucket or the cost bucket, what's leading to the increase? How much of that is CPA? How much of that is labour? And then to a certain extent, installation costs rather. And how much of that is incremental promotional activity, which you might be doing.

And then the second question is, if you have CPI-linked price increases embedded into your terms and conditions in your geographies, either one or any or all or whatever.

Vincent Litrico

One thing that I need to clarify for you is the increase associated with the IFRS-15 accounting. This is not something I typically comment on. Last quarter it was €9. So not material. This year it's slightly north of €100.

Basically, we capitalised revenue and then amortised it over the average contract length we have with new customers. And that typically is very short lasting. It varies from nothing to two, three, up to four years in some geographies. About two years on average. So again, we fully comply to IFRS 15 rules. But that introduces a little bit of noise in the metrics. And usually this is small. This quarter, unfortunately, it's a bit more significant.

If you look at quarter to quarter Q2 this year versus Q2 last year, indeed, our reported CPA went up €222. Again, almost half of this pretty much is due to accounting impacts. And I can get into some more details. I don't want to bore you with how–

Vivek Khanna

We can take that offline, but can you just tell me one thing? Where is the balancing item of the accounting adjustment?

Vincent Litrico

Absolutely. So that's where I'm going next. We still have €100 increase in CPA quarter on quarter. Before getting into the details of where that came from, you know that Q2 last year was also particularly historically low. Q2 2020 was more than €130 higher than Q2 2021. And that's tracing to a lot of different reasons. But if I look at just quarter to quarter this year versus a year ago—

Austin Lally

Fundamentally, Q2 2020 Covid shutdown, tiny volumes and therefore our high fixed-cost impact. Q2 2021 somehow post-Covid exuberance, where we had dramatically lower workloads and also, we were able to take advantage of things like very soft media markets and so on. So, neither of those years are particularly good marks to compare Q2 2022 against. I guess the key point, even if you take the IFRS out of the equation, there's clearly still €100 or so of inflation. And this is right across the board. It's higher material costs for electronics. It's unit marketing costs clearly being higher as many advertisers, including us, are pushing harder in a more difficult environment to create demand. That's why I made the point in my opening remarks that we acknowledge the CPA is up at this point in time. But the volume that we're bringing in is still very valuable, attractive volume because of the lifetime value of the customers.

Vincent Litrico

And just to give you some more specifics on your question. Out of the balance €100, a bit less than half relates to material costs. Remember, the lion's share of our transacted material cost is in the electronics field, which is denominated in US dollar. And of course, there's been adverse effects impacts on top of shortages in microchip semiconductors, which has been pushing prices up, as we commented before.

The balance is mostly external marketing cost inflation, which we had commented before. Again, coming from a low, as commented, just on the back of Covid where we managed to lock very good rates. Obviously, things have been coming back. If I now look at the balance, I think part of the question was around salaries and the cost we control directly. These have been quite muted, much smaller percent of the increase we faced overall.

Austin Lally

And I guess your second price-related question. I think as a company year on year have a very strong historical track record of being able to handle inflationary pressures. In general, if you take a long-term view, we've actually priced up ahead of the inflation that we faced, which is why obviously we've built margins significantly over time. And I think that the pricing that we took in Q1 2022, that's basically associated with the entry ARPU that you've already seen, of about 1 euro. And I think without getting into a forward-looking discussion, obviously, the thing that we are now watching like a hawk is what the likely inflation perspective is going to be for 2023. And that's going to be a combination of effectively those three key elements, which will be around acquisition, marketing, and materials. And then when it comes to the operation itself, obviously the single biggest cost element that we have is labour. And so, we'll be watching carefully how we think labour markets are going to evolve over time.

I guess the good news is, these are challenges that every business is facing, like in the current environment. And I guess most businesses don't have the track record of pricing power that we've demonstrated. Because they don't have the solidity or the resilience of a highly loyal, satisfied portfolio that we have.

Vivek Khanna

So, it's going to be sort of on a market-by-market basis. It's a commercial decision and nothing sort of baked in into terms and conditions?

Austin Lally

Well, that varies country by country. That's partly contracts and, frankly, local consumer law. So, it's not a one-size-fits-all. But whether in Market A we've got the contractual ability to increase or not, we've generally felt those questions are fairly irrelevant. Because whether you tell a customer that there's a clause that allows you to take the price up, that doesn't change the customer's ability to cancel. So, I think what we try and do in a careful way is we look at our costs, we look at the service we provide, we look at the spending power of our customer, and we just try and make an intelligent, long-term decision.

The reason this is important, by the way, is that we've got a customer lifetime now that on average is 15 years. So, the most important thing for us when we try and figure these questions out is how do we protect and build our margins, yes, but also, how do we extend the lifetime of these very valuable customers? And you've got to look at both things together.

Vivek Khanna

And, sorry, just to circle back one second. On the remaining hundred, which is the IFRS-linked, just back of the envelope I'm thinking, the counterbalancing item will be lower working capital outflow. Is that a right way to look at it?

Vincent Litrico

Not really because it's non-cash item. So, it's not going to be on the cash flow statement per se.

Vivek Khanna

Okay. All right. I'll send you an email offline later but thank you very much; it was very helpful.

Operator

Our next question comes from the line of Michael Hemmings of CVC Credit Partners. Please go ahead.

Michael Hemmings

Hi there. Thanks for taking my question. It was just a quick one on the attrition rate. I know the comment you made in the presentation that's still well below historical highs, and I appreciate that, however, historically, we've seen a bit of an increase in Q1 when you put through the price increases and then that tails off for the rest of the year, which has not been the case here. So, I was wondering if you could provide a bit of colour on how you see that developing into H2, given the consumer confidence and cost of living squeeze across the geographies. Thank you.

Austin Lally

I think, coming back to this question, you're absolutely right. We always get a seasonal effect on attrition. We typically price at the start of the calendar year. And we normally actually price once. I think in terms of managing the customer relationship, we typically don't go out with multiple price increases through a year. And if I look at 2022, certainly that Q1 bump has lasted longer into Q2 this year than in previous years. And we think that that's clearly because of the external environment. It's obvious. We're a peace of mind company and we know that households across Europe in general are worried.

I'm not going to give you a forward-looking projection for H2, but certainly my expectation is that the further away you get from the price increase, you obviously start to see these behaviours moderate. I would actually say that given what I'm seeing in the external environment today, I'm actually pretty pleased at the attrition performance in Q2. I think if you'd shown me, for example, the inflation rates, the economic indicators, the level of consumer concern, and you said, 'Well, your attrition would be 6.65 annualised in Q2', I actually would have bought that.

Now, we continue to work super hard on it, though. We're certainly not complacent. I think we need to see, for example, how families return after the summer vacation, what we call in continental Europe, the back-to-school period. We have to watch that very, very carefully. We also have to see where this inflation actually goes. And I'm sure that – I'm not going to be Nostradamus here – I'm sure every one of you as an investor is studying that topic, too, and trying to stay up to date. Is inflation going to end up being higher than people are fearing or is it, in fact, going to – as some of the indicators show – Is it going to moderate a bit quicker?

We don't try to be great forecasters. We just try and be agile. And I think for us the key decisions that we need to make in these areas are really around future pricing and what impact that has on the customer. But as of now, I think 6.65% annualised, that's still below that 7% mark that we've been below for the past eight years. And again, without throwing comparisons across other industries, we believe that that level is still not only the best in our industry, but we think better than all of the consumer service subscriber businesses that we've studied.

When I reflect on Verisure today, I think it's probably one of the two things that make us optimistic about the future. Number one is the amount of unmet demand that are still out there. These are still relatively lowly-penetrated markets in Europe. That's why even in probably the most difficult economic situation, Q1/Q2, we still grew our new installation rates. I think that was very creditable. I'm very proud of our commercial teams, of our sales organisation, of our marketing teams for delivering that. It's certainly not easy. It certainly has come at a higher cost as we've talked in the previous question, but really, really solid volume growth.

I think the second thing that makes us optimistic about the future is the solidity of the portfolio. And we just have to keep working on that. Again, that doesn't happen by accident. As I mentioned in my remarks, it's really tracing to two things. It's the quality of the customer intake in the first place. We work very hard to qualify our customers, to bring in high-quality customers that are going to be there for the long term. We're absolutely not, for example, chasing shortcuts on volume. That's even more important in a difficult economic environment. We've got to make sure the customers that we bring in are the right ones.

And then the second thing that it traces to is the customer experience. That's why we put so much focus on things like Net Promoter Score on our product and Service Excellence Program. We really want Verisure customers to be with us for a lifetime – 15 years on average now as Vincent pointed out. Many years longer than any contracts. We don't have contracted customers; we have choiceful customers. And I think that's something that remains a very, very big priority for us.

So hopefully that gives you some colour around the attrition topic.

Michael Hemmings

Yeah, that's super helpful. Thank you. And just a quick follow-up on that. You're saying about quality of customers. As a kind of barometer of that, how have you seen customer receivables develop? Is there any kind of concerning increases in that over the last couple of months?

Vincent Litrico

Not really. Generally the lion's share of our customers pay upfront, through direct debit. So, what I mean by the lion's share, it's north of 75%. So, we typically collect our cash immediately. There's a few instances where we even get actually pre payments from customers that are on quarterly payment terms. Some are even on yearly payment cycles. But that's a minority. So overall, the performance of receivables continues to be good on the cycle fee.

Austin Lally

That's pretty important. Obviously, let's be clear, someone who's not paying their bill isn't a customer. We're quite disciplined on this topic. I think we have very, very good collection processes, customer follow-up processes. Because what we don't want to have is a whole bunch of hidden attrition accumulating over time, and which I think is obviously one of the things you're probing in your question.

Michael Hemmings

That's super helpful. Thank you very much.

Operator

Our next question comes from the line of Hal Monee of Boundary Creek. Please go ahead.

Hal Monee

Hi. Thanks for taking my question. I have two, actually. So, the gross additions were quite strong, like you point out. So, would you be able to discuss was it across your portfolio of countries or were certain countries driving that strength? And I know we've discussed the attrition topic in detail, but another question there is have you been able to analyse the cohort of customers that have been leaving? Is it customers who have been there for a long time who have been leaving? Or is it newer customers who are reacting to price increases? Any colour there, if you have that, will be super helpful.

And lastly, the supply chain issues, are you still seeing those? Are you seeing them ease off slightly or is it still a tight supply chain?

Austin Lally

We certainly see the supply chain easing. We're not out of the woods. Our procurement teams continue to do superb work, and also the strategic suppliers that we partner with. I've personally contacted all of them over the course of the past months to thank them for going above and beyond, so that we've basically been able to meet all the demand. We say proudly that we haven't lost a sale because we were unable to supply equipment. So that's been important. I think there's still some challenges ahead, but I think the worst of the supply chain problems that we had are behind us.

On the attrition cohort question. Without getting into decimal points, broadly speaking, there's no real change in the profile of who's leaving. If you analyse why people leave us, there's a range of reasons, but the obvious ones are, number one, are moving home. Actually, it's generally the biggest. It's one of the reasons again, I'm quite optimistic about the attrition topic overall because I think that we do quite a good job on home movers, but I think we could do better. There are plenty of customers that move home, and we probably could have done a better job of moving with them. Some of our processes in some countries have been, in a way, not responsive enough or flexible enough.

The second topic is obviously economic. If you're the owner of a small business and it closes, there's not a lot that I can do on the telephone to help. If you're a family and you become unemployed and you've cancelled Netflix and you've cancelled your Sky subscription, and finally, the thing that's left is your security subscription, I do want to help in those situations, but there will be some customers that we will lose for economic reasons. I guess the positive side for us is that the typical Verisure customer – again, it's not exhaustive – but the typical Verisure customer is what you would call a white-collar, middle-class homeowner. And so, we tend to be less exposed to the violent economic swings than some other businesses face. But it's clearly still there.

And then the third bucket, that's always the one that pains us the most, it's our customer leaving because they weren't happy with the service. And, my view, every single customer we lose like that, that's utterly unacceptable. I can't control the macroeconomic situation, but I can certainly do a lot to control things like the home move. And I can certainly do an awful lot to control the quality of the experience that the customer gets.

So, net-net-net, I describe the attrition changes as a modest uptick. I think that's still how I would describe it. And the profile within that hasn't changed that much.

Vincent Litrico

Then maybe to comment on the first question you had on the country mix specifically, we actually don't provide specifics, but we were pleased with the performance across the portfolio. If you look at the portfolio across our various clusters, they were all in positive territory, which is really what we're happy with. Bringing more peace of mind to more and more customers.

Austin Lally

And remember, there's always been a mix effect in our growth profile. It's obvious, for example, that if you look at the percentages, we clearly post the highest percentages in our expansion start up markets. Some of those markets were doubling in size every year and that's great. But then you look maybe at some markets with the percentage increase isn't as big, but the absolute volume, given the base is so large, is very, very significant. So, if I look at our biggest countries, for example, like Spain and France, we are really happy with the growth that we're posting there.

Hal Monee

That's extremely helpful, all those responses. Thank you for taking the time. And just one question on the Sweden investigation. Any update you can provide?

Austin Lally

I think, no real material update. We've obviously received information requests locally from the commissioner. We've already submitted, I think, one significant dossier highlighting the professional practices that we're actually quite proud of. So, I would say we continue to work with the regulator, the local commissioner. And I think as a company we're clearly targeting a good outcome in this case. And I guess we'll keep you posted.

Hal Monee

Thank you so much.

Operator

Our next question comes from the line of David Brookes of Arkmont Asset Management. Please go ahead.

David Brookes

Hi. Thank you for taking the time. I guess I just wanted to, first, I had a similar question on the IMY, but that's what you were just talking about, I think. Can you just confirm when there might be an update in the process?

Austin Lally

I wish we knew. But I guess basically the ball's basically in their court now. And we're looking forward to not only a speedy resolution of it, obviously we want the best resolution of it. So if the regulator takes the time to study it properly and to go through our responses in detail, that's obviously good for us.

David Brookes

Understood. Thank you. And then on the Norwegian class action, I think your disclosure said that they have until mid-September to appeal. Is that expected that they would still appeal—?

Austin Lally

I can't really speculate on their behalf. I think they have until the 16th of September. I think that we're actually quite happy that we've, obviously, we've basically won every round of this so far, because we think the thing is without merit. And let's see. They can obviously choose to appeal, but then, of course, it then becomes another round of legal pleading. And I would say that we've prevailed on each step so far. So, we're not losing. On the one hand, we're not complacent, on the other hand, we're not losing sleep on it.

David Brookes

Understood. Thank you very much.

Operator

Our next question comes from the line of Mandy Jong of Fairoak Capital. Please go ahead.

Mandy Jong

Yes, thanks for taking my questions. Do you mind giving us more colour about the new customer components? I basically just want to understand, for example, the new clients, they are more like the people moving to new house or even they have been living here for a while and they want to shift to your subscription, or do you more target the people who own new business stores. Can you help us to assess the demand?

Austin Lally

I think maybe the first thing I would say, it's an excellent question, about our model is that it's a marketing-driven model. So, if you're living in most European countries, you'll see a significant amount of advertising either on TV or radio or digital. And what we're trying to do is we're trying to stimulate demand. We're trying to remind people for whom, I would say, for most people, security is not a top-of-mind question. Unless you've been burgled, and there are not that many burglaries day to day, you don't wake up in the morning and say, 'Wow, I'm going to get an alarm today'. Security is a bit like an insurance policy or a gym membership. You think, 'Well, yeah, that's a good idea, maybe I'll do it mañana'. And so the role of our marketing investment is to move mañana forward.

It's to get people to take action, and that marketing investment basically leads to bookings, to appointments for our salespeople, and the salespeople then use those face-to-face contacts with customers not only to sell, but, for example, to get referrals from neighbours, from friends and family. And, if you start asking the question, what do the new customers have in common? Actually, there's definitely a correlation with new housing. There's definitely a correlation with moving home. There's a correlation with having children. And that would be logical.

I spent 25 years in the consumer goods industry, and I think one of the basics in any marketing endeavour is that a change in your life is often a moment when you make changes in choices. And we certainly benefit from that. But I would say it would be an oversimplification to say that somehow the Verisure growth is because of housing or it's because of new businesses. It's actually a lot more broad-based. Basically, the common factor is that most of it is a response to our marketing. That's why actually we take most of the growth in the European market, because we create the growth.

We're not a company that just sits back and waits for customers to come to us. I think if we waited for customers to come to us, then we would be a much smaller company. That's historically why Europe was a low penetration market. Our job is to create the penetration. That's good for our company, it's good for our shareholders, but it's also good for society because it means that families are more protected.

Mandy Jong

Thanks. Do you mind giving me more details about your marketing and sales model? From what you just said, my understanding is like the marketing is more like the sales people need to see the clients face to face and one to one seems very time consuming and quite expensive way for sales.

Austin Lally

Well, it's not the only way we sell. We also sell online digitally. We also sell through telesales. We also sell through alliance partners. But most of what we sell is face to face. And I guess the analogy I would use is that it's very easy to sell cheap, basic solutions over a telephone or on a website. But that's not the business we're in. We are in the business of robust, professionally monitored premium solutions. And if it takes a Verisure salesperson a couple of hours to demonstrate the products and the service, to install the service for the customer, well, that's two hours compared to a 15-year lifetime value. It's actually not expensive. I think it's probably the most productive two hours of work that anybody could ever do.

So we're not interested in selling small, selling cheap, selling fast, selling and profit. What we're interested in is creating basically high customer lifetime relationships. And that takes a bit of time upfront. To use a little analogy, we want to be married forever; we're not into speed dating.

Mandy Jong

From what I've learned, seems like the market for salesmen is really tight right now. Does that mean you may increase salary or staff compensation to attract better salesmen?

Austin Lally

Again, it's an excellent question. Certainly, if I look through 2022 and the end of 21, the labour market certainly tightened.

We are still bringing in the salespeople that we need to bring in. We're still bringing them in on economics that basically make sense for us and make sense for the salespeople. So for example, if you talk about the CPA topic that we went to earlier, the increases in CPA we've seen have really been around equipment and have really been around marketing investment. They haven't really been around sales commissions. But what's clear is that we're having to work harder to get those recruits in. And what that means is basically having to screen more resumes to get the right number of salespeople, having to do more orientation meetings. We think of this as a funnel. So, we must do more work to bring more into the funnel, to get the salespeople that we need.

That's also not the case in every single country. I think it varies market by market. It's also related a bit to the comment Vincent made earlier on growth rates. Obviously, the markets which are growing the fastest, for example expansion markets, those are also the markets where you've got the highest proportion of new salespeople coming into the system.

So far, I would say, recruiting has not been, overall, like a material barrier to the growth. And you basically see that in the new installations – 206,000 in the quarter. I think that the volume remains strong. I think the challenges that we find today like in the quarter are not really in volume. It's really been around cost pressure.

Mandy Jong

Got it. It's really helpful. Thank you for the answers.

Operator

Our next question comes from the line of Richard Lee of Post Advisory. Please go ahead.

Richard Lee

Hi. Thanks for taking my questions. I have a few. The first is on the IFRS accounting, which you said increased CPA by €100 quarter over quarter. Is that a non-cash charge?

Vincent Litrico

Correct. Totally non-cash.

Richard Lee

Okay. But that still flowed through the reported EBITDA of €267 million?

Vincent Litrico

Correct.

Richard Lee

Okay. Maybe I'll just follow up offline with you guys on that accounting. But back to the CPA. So then the other 100 euro you said of increase was primarily through higher material costs. Now, are you passing that along in terms of upfront fees? Are you recouping all of that back through your new customers?

Vincent Litrico

Frankly, every new acquisition is a discrete decision we make, and the key thing for us is making sure, as Austin mentioned, that we bring high-quality customers that are going to stay with us for more than 15 years. So whether we pass a slight increase in material cost upfront or not is really not where the big prize is; it's more securing that we bring solid customers on good entry economics and then over time continue to please them, retain them and actually further increase the cycle fee and do a great job at delivering the peace of mind we offer.

So there's a lot of trade-offs that we could be looking at in a given quarter, depending on various elements. Usually, broadly, yes, we pass on, our intent is indeed to pass on the input cost inflation to customers at the initial moment of truth that we have with the customer at the kitchen table when we sell our proposition. But honestly, if €50 is getting in the way of landing a great customer, that's going to be with us for lifetime, that's something that the local sales guy doesn't have the discretion to do, but there's escalation mechanisms where we could occasionally offer discounts upfront.

Austin Lally

What Vincent is describing very well here is the importance of taking a real long-term, I would say, hard-nosed economic view here. Let me give you a simple example. If I wanted to minimise the upfront investment, then what I would do is I would sell customers simpler systems with fewer components. And probably the upfront revenue relative to the cost of the material, I could actually make that quite profitable. But that would be silly, because what we know is that the more comprehensive the installation that we put into the customer's home, the better the security, the more satisfied the customer is, but more importantly, the stickier the customer is.

And so the idea that you primarily try to maximise upfront revenue from the customer, that's not our strategy. What we try and do is we try and look for the sweet spot of getting the customer the best possible system combined with the customer paying enough for that to be invested, so that the customer is truly investing, because we know that a customer that's invested in the system is a sticky customer and solving, therefore, for lifetime value. And we try and look at these things in the round.

And so in general, yes, we do cover – apples to apples, installation to installation – we do cover increases in our costs, but there's also a different dynamic around – over time we've been trying to make the installations bigger and more complete and something that actually shows up as a CPA pressure as it often does, but we know that we're actually extending customer lifetime by doing that, and therefore it's the right economic decision.

Remember, you're probably on a lot of calls with different credits. Many of the people that you're lending money to are product companies. I come from the packaged goods industry. I would sell a box of detergent. I would try and calculate what's the margin on that box of detergent. Well, that's not the business we're in. We're not a product company; we're a service company. The products for us are basically an entry point into a lifetime of highly profitable service revenue.

Richard Lee

Got it.

Vincent Litrico

If I may, Richard, I got two questions on IFRS 15 so I suggest I carve out two minutes to provide a brief didactic answer. So briefly, IFRS 15, which was introduced in 2018, forced us to go through a number of steps. It is a contractual agreement with the customer and then apportion value over time during the length of the contract.

Roughly, big picture, we extract more cash upfront from the customers than the IFRS 15 rules allow us to recognise. And the way it's done basically, you look at what is the cost of installing the device at the premise, and slap on it a typical standard mark-up based on benchmarking. And that gets us basically something around €350. And you've seen that consistently we've been able to extract well north of that, close to €500+ per customer on average at the entry point.

So, what the accounting rules require us to do since 2018, is to basically carve out the difference – again, to make it super simple – €150, capitalise that excess revenue, and only recognise it over the initial contract length. It varies by country, by type of customer, etc. but on average we recognise such revenue over 20 - 24 months. That's the way it works.

Revenue from customers that joined us up to two years ago, typically neutralise with new customers. But this quarter it didn't. If you recall a year and a half ago in the context of Covid, I also mentioned that we had the reverse effect, because we had very little customers joining - less than normal customers joining us in Q2 2020, for instance. But we had the tail end of the amortisation of revenue that was capitalised before COVID, and so we ended up posting slightly artificially inflated upfront revenue per customer versus what I would qualify as true north, hard cash, that comes into the bank for us. But unfortunately, these are the accounting rules I have to live with.

So again, the dynamics of when you capitalise and then amortise or recognise the revenue over time can lead to some noise and that's basically what happened in Q2.

So again, to quantify it, it was €100 swing between Q2 2021 and Q2 2020. In Q1 it was only €9, which is why I didn't comment on it, and I'll only comment when there's actually material impact. But this time around, obviously it was material enough to warrant some explanation. I'll pause here. Hopefully it was not too much heavy accounting, but that's basically the way it works out. And I welcome any questions to follow up on this via email, which I'll obviously respond to.

Richard Lee

Got it. Thank you. I appreciate that. Just two more questions. Q2, you're saying is a record Q2 – 206,000 ads. In light of the macro conditions, high inflation, and on top of that, you guys pass along some price increases. It sounds like CPA costs are flat to maybe even up for new customers. With that being said, I know you don't give forward guidance, but can you provide any kind of commentary on how July and August are shaping up in terms of those gross subscribers as well as attrition, how that's been holding up?

Austin Lally

I don't want to get into giving you the Q3 numbers in Q2, but I think that the optimism overall that we have for the year and the period beyond, I think, remains the case. Basically, we think that even in a difficult economic environment, the amount of white space like the relatively low penetration levels for security, we're able to bring in the volumes and, as I mentioned in the CPA topic, there is a question on how much you need to push. How expensive is the media? How many other potential advertisers are out there pushing? These are, in a way, questions that go well beyond our industry. We're not competing for airtime with other smaller security providers in general. We're competing for airtime with all the consumer companies, with all the service companies.

And so I think that the discussion we had today on acquisition costs, it's really a question of what does it cost you to get that potential demand that's out there?

And then I think on the attrition question, again, I don't want to give forward-looking guidance, but I'm positive on the solidity of our portfolio. Despite inflation rates getting posted across Europe in the first semester, which are the highest that we've seen in our professional lives, we saw basically only a modest uptick in attrition. And I think that reflects the quality of the intake that we have and the solidity of the portfolio. And we need to keep working hard on that. We're not complacent, absolutely not. But, again, as I said earlier, if you'd asked me 12 months ago, with inflation across Europe at these levels, would I buy a 6.65% attrition rate in Q2 annualised? Of course I would.

Richard Lee

Got it. That sounds great. And my final question is on the balance sheet. I believe you have a bond that matures next May, so less than a year out. Your revolver balance has increased. Any thoughts on how you guys are thinking about addressing the upcoming maturity as well as maybe pay down the revolver? In theory, this business should generate a ton of free cash. Any thoughts on dialling down the funnel channels to maybe generate some more free cash flow to pay down debt? Or are you thinking about hoping the high yield market, the leverage loan market, maybe improves over the next few months and then looking to trimming out some of that debt?

Vincent Litrico

That's something that's obviously front and centre for us, as we expressed also when we released Q1 results. And you may see we also introduced a comment in our quarterly report around that. We are monitoring the market conditions and indeed it's something that's a clear priority for us.

In terms of the second part of your question, frankly, back to what we've been saying, we continue to bring solid growth of high-quality new customers that deliver a great return on investment. And so, we still believe the best thing we can do is continue to do what we do best, which is to bring peace of mind to more customers. So, the idea today is not to accelerate the paydown of debt via curtailing or pushing on the brakes on the growth front. And so, as such, we are looking closely at refinancing. The capital markets have improved versus June. In due course we will come back to this set of investors and ask again for their confidence in our business model to refinance that piece of debt coming due in April or May next year.

Austin Lally

And maybe one other thought, not around refinancing or debt, but actually around competitive advantage. I think that these are more difficult times. You're all fully aware of that. I'm sure you're hearing that from every company that you are following. One thing I believe very strongly is that's a moment when the best companies can actually build competitive advantage. And I'm looking not only at absolute volumes or the robustness of the portfolio; I'm looking at market share, I'm looking at competitive position.

It's one of the reasons why I do continue to invest. I do continue to push, because I believe that the success of Verisure over the past years hasn't just been about growing this market. It's about building our market share in this market. And I think that this difficult economy is actually a moment when the best players, the most consumer led, the companies with the best products and services, the companies with the number one brand, with the best reputation. We actually have a real opportunity to build competitive advantage.

I was talking to one of our Board members recently and he offered me a great analogy. He said that in a Formula One race, when it starts to rain, it becomes more difficult for everyone to drive. So that's when the best drivers win bigger. And that's our mental model for how we're going to build competitive advantage through this difficult economy.

Richard Lee

Got it. Thank you for taking my questions and congrats on the great quarter.

Operator

And as we are running out of time, I'll hand back to our speakers. Please go ahead.

Austin Lally

Thank you, Moderator. Thank you all for participating on the call today and for the continued interest and support in our company. It was really a great Q&A session. We don't always run out of time on the Q&A session, so that's a great indicator of interest, and I think the questions were all on point. And thanks for asking, because it gave us the opportunity, obviously, to give our perspective on these important topics.

I've got a few closing remarks I wanted to make. We remain fully aware that these are serious and difficult times for many families out there. We're not tone deaf on this. There's high inflation. There's energy prices. There's still a war taking place on the European mainland. Families are worried about the cost of living. There's also this cloud around us on the fear of a recession if it comes. And we are a peace of mind company.

We think that part of our role in this environment is to provide peace of mind to families that may be worried and troubled. And the way we do that is actually simply by continuing to provide an excellent service, 24/7 every day of the year to families and small businesses. And as you saw in our results today, our portfolio is robust, our service levels remain high, our new sales performance is strong, our financial delivery is strong. We've delivered another strong quarter, another strong semester. We've got another semester ahead of us. But we're going into that period, having already achieved new records again on our portfolio and our performance metrics

And thinking about the future, I used the phrase earlier ‘quiet optimism’. We acknowledge that it's a more difficult external environment, but we see the opportunities are still there. We still see strong demand for new sales. You saw that in the Q1 and in the Q2 numbers. Even if some households are under pressure and may consider delaying some discretionary purchases, and I'm sure that's the case, the amount of white space for us remains so significant given that we operate in relatively low penetration markets.

We also believe, I guess, on a secular basis, that the fundamental consumer need that we serve, peace of mind, is only going to increase in importance and relevance in the future. I actually think peace of mind matters more in difficult and uncertain times. So that's a responsibility we have, but it's also an opportunity for us as a company. Our intention as a company remains the same, which is to serve more customers, to serve them better, to continue to innovate, to continue to grow and develop our talent, to reinforce our culture, to be an effective contributor to a more sustainable future, to be a closer partner to society, including police and emergency services, to become a stronger company, a leaner company, a more effective company. And I think in a world that's volatile and less safe, we can actually leverage these unique strengths and assets to deliver the differentiated value creation and competitive advantage that I mentioned a few moments ago.

So, in closing, again, many thanks for your interest and support and for all the questions, and we look forward to talking to you again in a few months.