

Transcription

Verisure Group Q4 2022 Results

22 February 2023

PRESENTATION

Operator:

Welcome to Verisure Q4 Report 2022. Today I am pleased to present CEO, Austin Lally, and CFO, Vincent Litrico. For the first part of the conference call, the participants will be in a listen-only mode. During the questions and answer session, participants are able to ask questions by dialing star five on their telephone keypad. Now I will hand the conference over to the speakers. Please go ahead.

Vincent Litrico:

Thank you, operator. Good afternoon and welcome to our Q4 2022 results presentation. As always, participants on this call are our CEO, Austin Lally, and me, Vincent Litrico, the Group CFO. You can find our Q4 2022 earnings report and presentation in our corporate website.

Before we start, let's have a quick look at the agenda on page 4.

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

And with that, I hand over to Austin.

Austin Lally:

Thank you, Vincent, and thank you all for participating in this call today. And more importantly, for the continued interest and support in our company.

Today we will present the results for Q4 2022 and the full year 2022 for the Verisure Group.

I am glad to share that we had another strong quarter both operationally and financially. 2022 was another strong year for the Verisure Group. Given the external context in 2022, with high inflation, the impact of the war in Ukraine, predictions of recession and an ongoing cost of living crisis for existing and potential customers, we are very pleased with this continued strong performance. And proud of our team right across the Company.

So, let's start with our Q4 performance highlights on slide #5.

We had 196 thousand new installations in the quarter. We are now proud to protect more than 4.7 million customers. We have added over 475k customers to our portfolio in the last twelve months. Our portfolio grew by +11% year on year.

Our total revenues were up +11% in the quarter. Our portfolio EBITDA was up +14% in the quarter, reaching 435 million EUR. Quarter after quarter we continue to reach all-time highs. Annualized, our portfolio EBITDA is now close to 1.74 billion EUR. Total adjusted EBITDA was up +14% in the quarter. And we did this of course while preserving strong unit economics, despite inflation pressures. We view this as very strong and robust financial delivery.

As you know, with the support of many of you, we successfully issued 450 million EUR of Senior Secured Debt last month to fully refinance our RCF drawings. Besides 200 million EUR maturing in 2025, all our debt now matures in 2026 or beyond, and is 70% fixed.

Let's now move to slide #6.

Our customer portfolio has 477 thousand more customers than a year ago. We now have a portfolio above 4.7 million customers. This corresponds to a net portfolio annualized growth rate of +11.2%.

Let's now move to slide #7.

As mentioned earlier, it was a robust quarter for new sales. We added 196 thousand new customers to our portfolio. This is our second strongest Q4 ever on new sales. It is basically in line with the new sales in Q4 2021, slightly up despite a more difficult environment. Looking back 2 years, remember that Q3 2020 and Q4 2020 were truly exceptional quarters in terms of new sales as we benefited from surging, pent-up demand after lockdowns ended in many geographies. And families choosing to spend on their homes.

Let me also comment briefly on CPA. In Q4, our CPA was 1,425 EUR. It is up +4.6% versus last year. The picture remains the same as in the recent calls. Like everyone, we are seeing some inflationary pressures across our cost structure. But even with this current higher level of CPA, we are still creating valuable, attractive customers with a very high lifetime value. The payback on new customers remains attractive. Investing in these new customers is still a very good use of capital. And of course, on CPA overall, we continue to innovate to find more effective and efficient approaches.

As normal, we don't give formal forward-looking guidance. But we are still optimistic about the future. We see the external economic context improving. And we still see strong demand for new sales. This year we added around 200 thousand new customers every quarter, totalling over 800 thousand new customers in 2022. That is up +4.2% year on year, and our strongest full year ever in terms of new sales.

There remains a lot of white space out there. That makes the difference even if many households are under pressure and are considering whether to delay some discretionary purchases. We made key strategic choices some years ago. To compete in relatively low penetration markets which still have a long runway ahead. And to focus on building penetration and creating customers with a high lifetime value.

Let's move to attrition performance on slide #8.

The trends we have discussed in previous calls remain. We see that households now have to reassess their spending choices more frequently, not just a couple of moments per year.

So, controlling attrition has certainly been a priority throughout the year. In Q4 2022, we saw another small uptick, as the first wave of our 2023 pricing communication landed in some markets. Our total LTM attrition has ended up at 7.2%. These are still levels we are comfortable with. Levels well below historical highs. Our performance shows resilience and strong customer loyalty in this environment.

We believe this performance leads not only our industry, but subscriber-based consumer services overall. It shows that professional and differentiated security Verisure provides, with unique technology that delivers against key promises, remains a high priority for our customers even when they have to make other tough budget choices. Our solidity also reflects the high-quality customer intake and the focus on customer experience.

Value creation is not just about the total portfolio. We also pay strict attention to the profitability of individual customers. So, we are now going to look at Earnings per customer, EPC, on slide #9.

In Q4, we continued to enjoy excellent Earnings per Customer. We reached 30.8 EUR per customer per month, +2.4% versus last year and our strongest Q4 performance ever. Taking a longer-term view, over the past 5 years, we have grown EPC by over 5 EUR per month. That's more than 1 EUR per year.

Average revenue per user, ARPU, increased to 43.3 EUR per customer per month in Q4, up +2.1% versus the same period last year. This, together with the portfolio growth discussed before, translated into incremental total portfolio revenue of 75 million EUR in the quarter compared to the same period last year, representing a year-on-year growth of +15.4%.

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

Vincent Litrico:

Thank you, Austin. Let's move to slide #10, to discuss our Key Financial Metrics for the quarter. Verisure Group delivered another strong quarter of financial results. Revenues increased to 725 million EUR in the quarter, up +11% versus last year.

Portfolio Services EBITDA, our key cash generation measure, reached a new record-high of 435 million EUR in the quarter. This is an improvement of +14% vs. last year. Our Annualized Portfolio EBITDA is now close to 1.74 billion EUR.

We continue to enjoy sustained high profitability levels in our Portfolio. Portfolio EBITDA Margin was 71% in the quarter, a slight increase vs. the same quarter last year. As a reminder, in Q4 2020 we enjoyed all-time record profitability levels due to abnormally low operational activity due to the COVID situation. This is fully normalized now. If you look at it over time, we have improved our Q4 Portfolio EBITDA Margins by over 1 percentage point per year on average during the last 5 years.

Total Adjusted EBITDA reached 297 million EUR in the quarter, up +18% vs. the same period last year.

Cash Flow from Operating Activities increased +62% in the quarter to 284 million EUR. This is the result of stronger underlying cash flow generation in addition to stronger cash flow from working capital items.

Total Capital Expenditures increased +7% vs. last year, reaching 235 million EUR in the quarter. Net Debt closed the quarter at 7,383 million EUR, an increase of +3% vs. last year.

Finally, we have 279 million EUR of financial headroom as of December 2022, from a combination of cash on balance and available funds under our Credit Facilities. Pro forma for the 450 million EUR new Bond issued last month, which was used entirely to refinance RCF drawings, available liquidity is as strong as ever.

In summary, we have delivered another quarter of strong financial performance.

Turning now to slide #11, we show a detailed view of our Income Statement for the quarter.

Looking first to items excluding SDIs, Revenues stood at 725 million EUR and total EBITDA at 297 million EUR, what translates into a total EBITDA margin of 38%. Strong double digit growth while improving margins.

Depreciation and Amortization reached 124 million EUR in the quarter, and Retirements of assets reached 26 million EUR.

Operating Profit closed at 146 million EUR, what translates into an operating profit margin of 20%.

Net Interest Expense increased to 91 million EUR in the quarter up from 75 million EUR last year, driven by higher cost of debt. Other Financial Items remained broadly in line with last year, at -1 million EUR.

In total, Result Before Taxes reached 54 million EUR in the quarter.

Now, looking to Separately Disclosed Items, and starting at the top, we incurred into 19 million EUR of operating SDI expenses during the fourth quarter of the year. These are mainly related to ongoing transformational projects.

Furthermore, we recorded 16 million EUR of amortization of acquisition related intangibles. Most of it relates to the amortization of the contract portfolio acquired in 2011 from the Securitas Direct Group. This amount is obviously non-cash.

Separately disclosed Other Financial Items reached -15 million EUR in the quarter. This is the result mostly of negative non-cash FX revaluation of debt items and unrealized derivatives of -9 million EUR, the amortization of prepaid financing fees of -3.5 million EUR, and a negative IFRS 9 adjustment related to the modification of loan agreements of -1.5 million EUR, in addition to some other minor items.

Finally, if we now look to total numbers, we see that Income Tax for the quarter was -36 million EUR.

All in all, this results in a reported Net Loss in the quarter of 32 million EUR.

Let's now turn to slide #12, where we show an overview of Cash Flow Generation and Change in Net Debt.

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 over 4.7 million customers. In 2022, we generated 1,694 million EUR of Portfolio EBITDA.

As you know, we deliberately chose to invest a significant part of the cash generated from our growing subscriber base to continue the growth cycle. We invest to acquire new high-quality customers that will remain with us for about 15 years on average.

This is what we call Customer Acquisition Investment. Part of that investment goes to replace attrition, and part to fund the portfolio growth.

Despite having posted negative net cash flow of 238 million in 2022, you can easily run the math of how much cash we would have generated if we had not invested in additional growth. However, we believe that the best usage of cash is to continue bringing high quality customers to our portfolio with high lifetime value. We achieve ROIs of around 20% on each new customer we bring, which is well above our cost of capital.

Portfolio and Other Capex further contributed to a 249 million EUR outflow. Portfolio Capex of 94 million EUR mostly relates to new equipment for existing customers. Other Capex of 154 million EUR includes capex related to R&D, IT and premises.

Change in Working Capital has negatively impacted cashflow by 39 million EUR in 2022. This was mainly driven by inventory build-ups, increases in trade receivables and other receivables, partially offset by decreases in other payables.

Paid Taxes accounted for 77 million EUR and Paid Interests and Financial Items accounted for 310 million EUR in 2022.

SDIs and Other contributed with an additional 91 million EUR outflow.

All in all, we recorded negative net cash flow of 200 million EUR, what translates into a negative net debt variation of 211 million EUR, considering lease debt increased by 10 million EUR.

Let's now turn to slide #13 to cover leverage.

As you know, we have delevered and levered up on several occasions in the last years.

We talked in past earnings calls about how COVID-19 impacted our operations and working capital in 2020 and in Q1 2021. We estimated these impacts to illustrate what our normalized Total Net Leverage would have looked like.

In Q4 2022, we have continued our deleveraging trajectory, and Senior Secured Net Leverage and Total Net Leverage closed at 4.8x and 6.0x, respectively. We have delevered 0.2x in the quarter and 0.6x in the year.

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 #14 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 have had very strong growth in new customer intake over the years. During the last 5 full years, New Installations have grown at a CAGR of over 16%. This year, we have grown at +4.2%. This represents an acceleration in our new customer addition pace versus 2021, which we find remarkable in the current external environment. All the growth was organic.

In parallel, we have a continued focus on improving customer experience and keeping best-in-class attrition levels. Although we have recorded a small uptick vs. last year, our customer loyalty has remained strong.

Strong customer intake and low attrition leads to strong Portfolio growth. We have enjoyed double digit growth rates in our Customer Portfolio for several years and we now have over

4.7 million customers. It is remarkable that during the last twelve months we have increased our portfolio by almost 0.5 million customers.

At the same time, this volume growth is complemented by a continuous improvement in unit economics and profitability by customer, EPC.

Improved EPC is the result of both 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.

EPC has grown at a CAGR of 4.5% between 2016 and 2021. In 2022, we have increased EPC by +1.9%. As discussed in previous calls, growth deceleration is mainly driven by some inflationary pressures faced during the year.

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. Portfolio EBITDA is now over 1.74 billion EUR on an annualized basis.

With this, we conclude this part of the presentation. I would now like to hand it over to the operator for the Q&A session.

Q&A

Operator:

If you wish to ask a question, please dial star five on your telephone keypad to enter the queue. If you wish to withdraw your question, please dial star five again on your telephone keypad. Please state your name and company. Please go ahead.

Jemma Permalloo, JPM Morgan:

Hi, good afternoon. Hi, Austin. Hi, Vincent. I had a couple of questions. About three to four questions. To start with, given attrition rate that's picked up to about 7.2%, we're getting to March. Is there anything that you can share with us in terms of how you're seeing the attrition rate shaping up for the first quarter of the year?

My second question is on the customer acquisition costs. I seem to remember that you have about 65% of your costs that's mainly coming from wages. What are you seeing in terms of wage inflation? Is that getting any better? Can you remind us of your inflationary pass-through?

Then the RCF, now given that's been refinanced, are you expecting to utilize the RCF to the extent that you did last year?

Then just, finally in terms of CapEx guidance, I'm conscious that you're not giving any formal guidance, but directionally, where do you see CapEx for 2023?

Thank you.

Austin Lally:

Maybe I'll just hit the first one really head-on. We obviously don't give Q1 guidance in the Q4 earnings call. It wouldn't be appropriate. We're only halfway through February. Certainly, what I would give you in terms of color is I'm quite encouraged about what I'm seeing at the start of the year. I'm going to wait for the month to finish and for the quarter to finish before making any pronouncements. I think as a company, we're actually quite optimistic again about how the price increases, for example, that we took have landed. Also, how we're starting the year. It's not just in terms of customer loyalty, but also, for example, new sales performance. Maybe I'll let Vincent comment on the more technical question.

Vincent Litrico:

Sure. The second question was on CPA as it relates to specifically wage inflation and how much pass-through we've seen so far. You rightfully noted that the number one cost of our spend pool is wages, given we are a service business. However, the lion's share goes mostly to the EPC side. It's on servicing the customer. If you look at CPA per se, of course, you have the cost of labor, especially salespeople. But most of the cost is customer acquisition costs, including material costs. Also, investment in marketing, to basically drive or activate the natural demand we see still out there for our proposition.

Salaries, wages, do play a role, but not as pronounced as what you would see on the RMC side, on the cost to service operations. Now, you're asking about wage inflation. The picture varies, obviously broadly, given the large footprint we have. I think we commented before that there's always a bit of a lag in salaries. It's because you don't revise or mark to market salaries on a spot basis. It's typically part of the annual compensation reviews. We do it once a year, which is typically happening now in Q1. For some markets, obviously, there is consideration for the inflation faced locally by our colleagues and our employees. It really varies by market quite substantially, as you know.

There's also an element of local indexation schemes in some countries. It is driven by the governments and the collective bargaining agreements. It's where you basically have a one-for-one translation of external inflation, not typically the headline inflation model, core inflation here. It's a translation of that into a salary wage increase. It's the case, for instance, in Belgium. It varies by country, but generally, yes, as we said before, we seem like everybody else; inflation is putting upward pressure in the wage spend pool. As we commented as well, we're basically pricing for that. That's partly what Austin alluded to talking about the price

increase partly already rolled out in the last quarter. Q1 is now all fresh with new pricing that enables us to continue to maintain margins on our business activity system.

Let me now move to your third question, which was regarding the RCF. We have fully replenished the RCF. We have a lot of financial headroom right now. In terms of the use of the RCF, again, we're not going to give forward-looking guidance on that. As you know, we're not acquisitive. We continue to be very focused on the core fully. All the growth you've seen for many years now is 100% organic. Unless there's a terrific tack-on opportunity that pops up, we don't have any plans to do anything else than what we do best. We continue to bring peace of mind to more and more customers.

On your question number four, again, we don't provide CapEx guidance. Again here, just as you well know, more than three-quarters of our CapEx is directed towards customer acquisition CapEx. It's basically the equipment and the variable sales costs. It's the investment needed to land a new sale and to deliver the installation at the premise of our customers. That's going to remain the lion's share of the CapEx. As long as there will be customers willing to latch onto our position, we're not going to let them unprotected. Of course, we'll be directing cash flow capital toward that. In terms of pace, you can see the trend and do the extrapolation yourself. If your question is more directly to the minority of our CapEx, call it less than 25 percent is directed towards upselling and R&D innovation. You've seen that our track record has been having a well-controlled level of CapEx intensity. It's to maintain our set at the Vanguard and at the forefront of innovation. It's to keep delivering the best possible propositions to our customers. That's what we're going to continue doing.

Operator:

The next question comes from Brian Ruttenbur from Imperial Capital. Please go ahead.

Brian Ruttenbur:

Thank you very much. Great quarter. I had a question, and it was about attrition in 2023. You may not be willing or able to talk about that. In your outlook, maybe in 2023, do you anticipate higher attrition rates in your projections internally? Maybe just trying to understand the attrition going forward, if you expect it to stabilize, go up slightly, then stabilize? Then I had another follow-on question.

Austin Lally:

If I give you my budget for '23, then I'm effectively just giving you forward guidance, Brian, as you know. I can't do that.

Maybe at a high level. I'm optimistic about the robustness of our portfolio. I was very impressed with what we saw in 2022. For example, in terms of things like saving rates. Also, our ability to save customers, for example, just with speech rather than by discounts. We focus a lot on the customer experience. We've always focused on a high-quality intake. That really comes to the front when you're in a more volatile period. I think that probably many people looking at our business in 2022 would have expected a much more severe spike in attrition than we saw. In reality, we had a modest uptick in 2022, so we're quite optimistic about where 2023 is going to go. Obviously, we're six weeks into the new calendar year. It's too early to really form conclusions. I'm certainly feeling optimistic.

Suppose I take a medium-term, longer-term view. It's not a guidance topic. No, not within our very specific timing horizon here today. I believe that longer term, structurally we can absolutely recover the attrition position that we had before as the economic cycle works through and as our new innovation kicks in. I have a lot of evidence that when customers start interacting more with the system, when they start interacting more with high-quality images on the app, and when they start accessing more digital services, attrition decreases. For example, when they start experiencing the power of an electronic door lock. Also, the combination of a door lock and maybe a video doorbell. It makes the front door experience something that the customer interacts with more often. Those experiences have proven to bring attrition down. Longer term, we certainly focus on how we can continue to improve customer loyalty.

Brian Ruttenbur:

Great. Then as a follow-up, just really quick, can you talk about some new products and where you see ARPU going in 2023? Is it going to be driven by video or is it going to be driven by electronic locks? Maybe just add a little color there.

Austin Lally:

I think the big news for us is that we've continued the roll out across the footprint of our latest product and service platform. Informally inside the company we call it Moonshot. That's the internal name for what's effectively bringing to the market what we think is the absolute best-in-class platform. That's now present across northern Europe. It's now fully present in large markets in southern Europe, for example, Spain and France, Italy and others. That's something that we think we can associate with the type of continued ARPU development that you've seen from the company in the past. It's one of the reasons why we are so focused on innovation. We believe that innovation is not only about doing the job better, protecting the family better and creating a better customer experience. It's also about defending pricing power.

Operator:

The next question comes from Vivek Khanna from Deutsche Bank. Please go ahead.

Vivek Khanna:

Hi, good afternoon, everyone. I had two follow-up questions, if I may. I guess the first one, and I apologize, is still on attrition and churn. I'm just trying to figure out what's the driver for the step up. I appreciate it's all manageable, but I'm just trying to understand if you are seeing clients moving to competitors or if they are exiting the market altogether. That's my first question.

Then the second question is with regards to the reported year-on-year revenue and EBITDA growth rates on a full year basis for the full-year 2022. I was wondering what that would be on a constant currency basis.

Then finally, obviously, you are involved in a bunch of geographies. Could you maybe just tell us one geography where the business is underperforming relative to your internal expectations?

Vincent Litrico:

On attrition, we obviously measure it closely by market. Understanding the reason for customers to send in a cancellation request, for instance, or simply stopping payment. We have a good grip on this. This hasn't evolved much in terms of the key reason. By far, the lion's share continues to be that the customer is exiting, not shifting to another proposition, to another competitor. They're just exiting the service.

Austin Lally:

Maybe just to add to this point, broadly speaking, with attrition in the six to seven percent range, the churn within the industry is about roughly a point, plus or minus. It's why we don't use the word churn, actually. In our internal discussions, we talk about attrition. It's because this is not a mobile phone business where people are just shoving into the competition the whole time. People are leaving for a variety of reasons.

Now, what's changed in 2022 is that the increase is basically all economic reasons. It's not about service. It's super clear. If you're a small business and your business closes, you're not going anywhere. You're not going into another competitor. There are obviously families who are really feeling the squeeze. We work very hard to retain customers and to try and help them stay. At the end of the day, if you really can't afford to pay for the service, some of these customers are going to leave. Certainly, some of what I would call the soft underbelly has already been under pressure and some of those folks have gone. That economic situation is obviously cyclical. It's not something that's fundamental to us. That's why I think you saw the increase in '22.

Had you said to me, for example, in September '21 that we were going to have inflation in European countries at 10, 11, 12 percent. There were going to be hikes on interest expenses and major worries about energy shortages. Effectively a cost-of-living crisis is unprecedented. If you'd asked me at that time, there was going to be a war in Ukraine, there was going to be an impending recession. If you'd asked me, I would have taken 7.2 percent attrition for the year, then I would have taken it. It's because it was a relatively modest change considering the scale of the context outside. Remember also this is far below historical highs. When I joined the company back in the summer of '14, we had attrition that was up at nine percent. We're not anywhere near levels like that today. Quite robust, we can retain it.

Vincent Litrico:

Let me answer your second question on constant currencies. This is something we disclose on the second page of our quarterly report. Literally, there's been very little impact. We actually quote in the text that portfolio service adjusted EBITDA increased 14.8 percent in the quarter. In constant currencies it would have been 14.7, so the difference is very small. It's almost no difference. In revenue terms, total revenue grew in constant currencies by 12.5 percent for the full year, which was your question. Reported EBITDA grew 13.7 percent for the full year in constant currency.

Vivek Khanna:

Then the last question was if there was any market in which you're feeling stress. I wouldn't say stress, but rather underperforming expectations on any market.

Austin Lally:

We generally don't get into a geographic split quarter by quarter on our key geographies and so on. The reason is that we don't really think that it helps you much as a lender, and it probably helps my competition a bit more. I tend to be high-level. If you look at the fundamentals of our value creation, let's say portfolio EBITDA, our ability to monetize our portfolio, we basically grow it in every single country every year like a clock. Look at our attrition performance. Although the absolute levels vary depending on the mix and so on, again, it's really a consistent performance.

Then I would say that from market to market, some years you'll have a better year on new sales than other markets. Those positions can change from time to time, depending on the role of innovation, depending how effective your marketing campaigns are. That's why I don't really like to get into commenting on how one country does versus another. It's because these things go up and down. What matters is overall. It's quite broad-based. 200,000 new customers per quarter last year. Again, if I just reflect, the portfolio is over 11 percent bigger than the year before. Again, I think that there will be lots of subscriber businesses around the

world in different sectors who would have liked to have grown subscriber numbers by 11 percent last year. Overall, I'm quite happy with the robust performance in the broad-based nature.

Man 1:

Good afternoon. Thanks for taking my question. I just wanted to ask again about attrition. I understand your comments about how if you were told a seven percent attrition rate, you would have accepted that, given the macro environment. Then could you maybe talk about at what point you are going to be more concerned? Is it nine percent? Is it 12 percent? What is the range that will actually start causing you more concern, firstly?

Then secondly, I'm just trying to understand this. It's clear that you said the lion's share of attrition is due to a more recessionary environment and economic reasons. Well, the proposition is identifying high-quality customers, as I understand it. Also, customers who you'll generate your target IRR from. Could you talk a little bit more about the cohort? When you've had 22,000 extra customers leave you this year versus last year, are those people who left before your payback period of four to five years? Are they customers who've left after ten years where you've extracted more value from them? It's because surely that's obviously quite important in terms of who's actually leaving you.

Vincent Litrico:

Let me take the second part of your question on overall cohort or attrition patterns by vintage cohort. Typically, the attrition you see, you slice into two or three periods over the lifetime of the customer.

Firstly, it's when they join us and at the point of installation. At this point NPS is excellent and outstanding. Some customers might change their mind, turn around within a few months and decide to quit. However, year-one attrition is very low. You have a bit of an uptick in year two. Year three to year four is where you see a bit of the peak. Then you go back down to a fairly low level for the residual time they spend with us. It's not a flat line. Once the customer has been seasoned, used the product, and is satisfied with what they're getting from our position, they stay here forever with us, pretty much. That's the way the pattern evolved and broke the curve.

Man 1:

Between those years, just very roughly, how much is year one?

Austin Lally:

No, I don't think we want to do that. We are very comfortable with how the curve looks. I don't think I should just give all my European competition my detailed loyalty and retention data.

Now, on your first question, which is somehow how bad is bad and when do you get concerned? It's quite an interesting phishing question. Let me just say, first of all, if you start throwing around numbers like nine percent, 12 percent, you're somehow on a different planet from how I'm looking at the business. It's maybe part of your answer.

You then come to how you manage the company as the CEO. This is quite an important topic. When I talk to the organization, I don't tell them what an acceptable level of attrition is. It's because if I told the organization that it was okay for attrition to climb by X or Y, what that does is, of course, take the pressure off the retention teams. You end up creating self-fulfilling prophecies.

Part of what we're doing here is a balanced communication. I'm telling you that I'm quite reassured and optimistic about where we are. We've got it under control. The short-term, medium-term, long-term picture of the company is positive. I'm good with that. I also know that the way we get there is to treat retention like a big topic. Also, we keep the pressure on the retention teams, and we keep the pressure on customer service. What I'm certainly not going to do is let the genie out the bottle and get into a communication cycle. It's where I'm justifying that it's okay for attrition to go up. We fight for every ten basis points on that number every month. We'll continue to do so.

Man 1:

Okay, that's helpful. I appreciate that. It's clear that you're comfortable with the levels. That makes sense, given the data you have. It makes sense; you wouldn't share data that you think will detriment you with your competition. Some of that, obviously, would be helpful for us to be as comfortable as you are. That's where I was getting to. It's like cohort analysis. That is acknowledged in any case.

Austin Lally:

Clearly, if I thought there was a big hole in our numbers, I wouldn't be sitting here as a major investor in the business, personally optimistic about the long term. I think that this whole economic situation in '22, following on from two years of the pandemic in '21 and '20, probably did more than anything to illustrate the solidity of our portfolio. Some of that in the past was theoretical. We used to tell people we thought we had the highest quality customers through the two years of the pandemic. In '22, we're basically giving an empirical demonstration that we have the highest quality portfolio. It's not just in terms of attrition, but our ability to price, our ability to defend our margins in an inflationary environment.

I'm going to repeat something I said in previous quarters. We're not just solving for the attrition number, to be clear. One way to try and minimize attrition, for example, is not to increase prices. Then even cut prices. That's not how we manage the business. We're actually

looking for the triangulation between attrition and customer lifetime. We're also defending our unit economics against inflation. That's our EPC, and it's our margin on the portfolio and its attrition. We keep working our way around that triangle because that's the thing that creates great economic value. For example, if I came out of the economic cycle with a particular attrition number, but I was showing you eroding earnings per customer. Showing you that my customers would become less attractive over time. I don't think that's a good picture.

We want to have low attrition. We want to have high customer lifetime value. High customer lifetime value isn't just because of the lifetime of the customer. It's also about the EPC per month that we get. When there's inflation in the mix, our ability to cover that inflation through pricing is also very important. We've not been shy about pricing. Again, that's one of the reasons why when I look at the attrition performance, I look at all this overall. I'm comfortable because I think we're making the right trade-offs between pricing, unit economics and attrition.

Andreas Jensen:

Hi, it's Andreas, Capital Four. I just have one quick question. Would you be able to give a bit more color on the annual price increase that you've taken? I think you commented that it was well received by customers, but just a little bit more color on the magnitude of the price increase.

Vincent Litrico:

Andreas, I suggest basically you dial in to the Q1 earnings call. That's where we're going to disclose some more specifics on the actions we've taken. More importantly, also how it's been received by our customers as we discussed.

Austin Lally:

We've obviously pressed enough for us to be comfortable that we're actually defending our unit economics and making the right decisions. These are questions, not just a question of, for example, what price increase you take but, for example, how many customers you choose to cover with the price increase, who you exclude and who you don't exclude, how you handle customers in the first six months, the first 12 months. It's quite about a nuance around pricing. I think we'll give you a fuller answer in Q1. As Vincent says, we can also show you the associated impact in terms of the ARPU flow-through. Also, for example, what happened to the attrition as a result.

Andreas Jensen:

That's perfectly fine, thank you. I look forward to the next quarter then.

Miquel Llesma:

It's Miquel Llesma from Bain Capital. I wanted to ask you about the average revenue per customer. You mentioned that you have put in place now price increase. It has been going down sequentially, like 10 cents per quarter, which is not a lot. I wanted to understand what's behind that dynamic.

Austin Lally:

The ARPU in Q4 was up two percent versus the same period the previous year.

Miquel Llesma:

I appreciate that. Sequentially quarter on quarter it has been eroding. It's not a lot. We could understand what's driving the decline. It's because it seems counterintuitive to me that average revenue is declining in the face of inflationary pressures.

Austin Lally:

Actually, first of all, not really because we price once a year. You could think the high watermark of your pricing will be in Q1 when you take it. However, then if there's been any discounting, for example, through the year, that obviously flows through. Then you also get into topics that are in the country mix and how ARPU changes depending on where the customer intake comes from. The portfolio is not the same quarter on quarter.

Vincent Litrico:

The other element of the answer to your question is something we don't disclose every quarter, but you need to unpack ARPU into two buckets. There's the RMR, so the recurring monthly revenue. It is very stable and that one is a lot more stable than the numbers you see. Then the difference between the two is that the second bucket is what we call other revenue. It has to do with upselling activity and extension upgrades, which includes mostly one-offs.

We upgrade the customer and we put for example the latest Moonshot technology in the premises. In most cases, we ask the customer to also contribute, partly to defray the cost. That could be in the form of 50, 600, 200 or 300 euros, depending on the type of equipment at stake here. Also, the extent of the complexity of the extension we're going to do or the upgrade. It could be a new camera. It could be a lot of different things. That is reported as other revenue. These are more one-off in nature. It's within the portfolio because it's serving existing customers, but it's different than the recurring monthly revenue. Obviously, the upselling activity fluctuates based on various things. We discussed it in 2020. Given the lockdowns, we had to cut down a lot.

Austin Lally:

Also, in reality, given that we did have an increase in cancellation request activity around the portfolio, there were certainly some markets where we actually moved operators from outbound upselling activity to retention activity. That was a very good decision. That can lead to plus or minus 10 cents of fluctuation on upselling revenue.

Miquel Llesma:

I wanted to ask you also about price increases. You mentioned that some of the upticks in attrition are due to the price increases that you communicated. What part of the price increases was communicated in Q4 and what part is being communicated now? It's so that we can understand where attrition is going to be more or less in Q1.

Vincent Litrico:

Well, if you're referring to the timing of communication, frankly, it varies by market.

Austin Lally:

I think few markets communicated in December, and most will communicate in January. It will be done pretty much in Q1. What I'm not going to publish on the website is when the issue of putting an invoice is out to market by market. Actually, probably that's even questionable from a competition perspective. I don't think I should be giving people advance notice of when pricing is taking place. It's not appropriate. A little bit in Q4 and most of it in Q1.

Miquel Llesma:

Okay, understood. Last question from my side. Last year, you had some headwinds on CapEx from Forex and the stronger USD. Given that now USD is lower than in Q2 and Q3, what would be the effect of the current forex rate on your CapEx and annualized CapEx? To say it another way, what would be like constant currency CapEx?

Vincent Litrico:

Firstly, we do have a hedging program in place. Of course, I think we mentioned many times the lion's share of the equipment that is transacted in the electronic space is denominated in US dollars. Of course, we are on the receiving end of it. When US Dollar appreciates, we feel the pain and vice versa. We do have a hedging program in place to smoothen the landing a bit or dampen a bit the volatility we get from effects. It's more to manage the operations effectively. Typically, we hedge part of the exposure over a rolling 12-month period, which means that we didn't get the spot mark-to-market hit from last year. And vice versa, we're

not going to immediately get the full benefit of the turnaround. For us, it's not really an issue. As we mentioned many times, it's not the lion's share of our cost structure, to be clear. It's mostly a one-off that we have plenty of time, 15 years plus, to recover over the lifetime of the customer. Again, that's not something I worry about at all in the overall business mix.

Miquel Lluesma:

Okay, thank you.

Emily McEachern:

Hi, this is Emily from Blackrock. Hopefully, you can hear me all right. Thanks for letting me ask a quick question towards the end of the hour. We've talked about attrition at length. It's around the number of customers you were able to retain via voice. Also, on those that you were then able to retain via some kind of discounting or certain agreements. It'd be helpful for us to understand what proportion of inbound calls you were able to defend. I guess you talked as well about reallocating resources towards retention. I'm just asking how successful you are generally on retention and whether that trend has changed.

Austin Lally:

It's nice to hear from you again, right. It's good to have long-term experts on the industry coming on. I'll give you a sort of broader answer. Try to put this in perspective. First, we think our ability to retain is high. Our save rates are high, and they have improved. They've steadily improved even through the years of the pandemic and in 2022.

Let's see, as the task got harder, as the external context got harder, actually, we got better at it. First of all, there's more volume, so people get more experience. We also are able to do more A/B testing on different scripts and approaches. It's in absolute high and improving on save rates. Now, the reason I don't throw a number around is you're often not comparing apples to apples. This can also vary from country to country and culture to culture.

There are some customers who are calling in, actually, without any real intention to cancel, but they're looking for a deal. There are customers calling in because they're really unhappy with the price increase. It's because, first of all, they don't understand why. They may have had, in their contract, for example, an automatic price increase. It's because they had a device like Zero Vision, where they had an introductory offer for the first six months, that expired, and maybe the customer has forgotten about that introductory offer, and it has to be explained to them. The save rates on those conversations are very high.

One other thing that's been very interesting in the past year. What we're finding is that many of those volumes you're talking about never get anywhere near the retention department. It's because we're able to handle them at the first line of customer service. Then you get into

this discussion around whether that is actually a genuine cancellation request that I've retained and whether I should include that in the savory or not. There are some pros and cons there. Some people argue you should put those calls straight to the retention department because they're experts. Of course, what's interesting is you pay your retention department on the number of retentions they perform. You could end up paying a lot of commission for retaining customers that were never going to leave in the first instance. The best practice for us is we try and handle as much as possible on the first line. Do it before escalating it to a specialist retention lane. In terms of what this all costs us, it's a relatively small number compared to the output that we have.

Emily McEachern:

That makes sense. Then I guess secondly, in the past and on previous calls, we've discussed the marketing costs within CPA and sourcing of customers. I think I've asked the question before about previous channels. Asked whether that could be through social media campaigns or more traditional media campaigns. Also, the return on that spend was lessening, and whether it was harder to find new customers. I was just wondering how that evolved towards the end of the year. Did you have to try harder to find customers that would have come easier in previous environments? Also, whether the inflation was more generic.

Austin Lally:

I think that there were definitely in '22 lower levels of natural demand. I mentioned in my opening remarks that discretionary purchases around the home were clearly lower in '22 than, for example, the pandemic period. In a way, what we saw in 2020 and 2021 was probably the reverse. Which was people were not traveling; they weren't spending money on vacations. They weren't even necessarily going out that much. If you were selling products for the home, you probably had two great years. If you were in the soft furnishings business, the home décor business, you probably had some good years. I'm not sure those industries had a very good 2022, even consumer electronics. People loaded up on a lot of electronics for the home, gaming and laptops, and kept connectivity to work from home.

Probably again in 2022, those consumer and electronic businesses paid back some of what they had pulled forward. Now, the alarm business isn't quite as up and down as that. Certainly, for some families deciding to move home, for example, it is a decision that they can delay. That's often associated with buying an alarm system or refurbishment a house. Again, that can get delayed, and that's also sometimes associated with an alarming purchase. We certainly think that the level of just natural organic demand in the market was lower in '22 because of the context. Therefore, our marketing teams had to go in and basically push harder to stimulate demand that wasn't just going to fall on our lap. That led to spending more. That

was also associated probably with a number of other industries, all having to basically go out and spend more to try and stimulate demand.

We definitely had unit marketing costs increasing. We've talked about that in previous quarterly calls. Then the question is, what's the marginal cost of the next booking that you're prepared to spend? We've tried to be intelligent country by country. We're not just going to stand to unjustifiable levels just to create a marginal booking. It's because, again, if I quoted what's the average marketing cost per sale, the reality is there's a big spread there. There are almost some sales which you get for free. First, an existing customer who wants to buy a second system. Also, an existing customer who wants to recommend something to a family member. There's no real marketing cost there. Then there could be a social media lead with a very low conversion that you pay an awful lot for. What we're trying to do every day, but particularly now, is we're trying to really be disciplined about limiting that.

Look at the '22 numbers. Our new sales were four percent ahead of a year ago. We still grew ahead a year ago. That's obviously a slowdown versus the year-on-year installation numbers that you would have seen few years before. That was a conscious choice from our perspective around balancing the growth and the cost of the growth. Again, the same thing will happen in 2023, which is when we're going to continue to grow the portfolio. We're going to continue to work on our new sales intake. We're going to pay careful attention to the cost of the growth at the same time. I'm again a bit like my triangle before on attrition. It's not just about attrition; it's about attrition and unit economics. I think the same logic applies to new acquisitions. The net portfolio growth is important, but the cost of that growth is also important.

It's because if you take the economic value that we create, it's the customer lifetime value remains as the acquisition cost. That has to make sense. We don't talk about this metric a lot externally. It's because, in a way, it's more of an internal mindset. If you take the EBITDA per customer per month and you multiply that by the customer lifetime, that gets you to a good proxy of the customer lifetime value. Then you deduct the CPA and that gets you the value created per customer. That's our focus. The CPA does matter on a marginal basis.

Emily McEachern:

Brilliant. Thank you so much for your time.

Austin Lally:

Thank you. Thank you, Emily.

Man 2:

Hello. I hope you guys can hear me. Thank you for taking the time. Just to start off, can you talk a bit about how Ireland is going for you given that it's a new jurisdiction you enter in '22 and there's an income there. I'm interested to hear how that's developing.

Austin Lally:

Listen, we're very happy with it, but it's really early days. We're talking about one sales branch. As we speak, I think the number of salespeople that we have in the start-up, you can count tens. It's really early days.

What I'm very happy about is we think that our proposition is very robust. The important thing when we enter our market, over the first year, it's a bit of learning on how the local job market works. Also, our ability to recruit salespeople, which, again, we're quite encouraged by. In addition, how many of them actually end up consolidating. Also, how quickly do we think we can build the sales structure and how easy is it to create the demand. Those are the questions that we grapple with in the early stages of a market. I would say on Ireland, quite encouraged/no surprises.

Man 2:

Perfect, thank you. Just generally on the composition of your new customers because you've been able to steadily keep adding new customers. How is that changing? Is it changing at all? Is it very similar or are you seeing maturing in certain markets and therefore, you're shifting to other markets?

Vincent Litrico:

It's pretty stable in terms of the customer type mix; business residential continues to be 80 percent residential and 20 percent small businesses. No major mix shift to call out here in terms of the makeup of our new installations.

Austin Lally:

Obviously, one thing we are focused on is a strong intent that each generation of customers that come in should come in with higher customer lifetime value than history. If you study our company, our average customer lifetime has been steadily increasing. The entry economics of new customers, for example, what you call the entry item RMR. It's, therefore, the new pricing for new customers. Again, that's a metric that we've been working on. If you take a longer-term view, that's been a metric that we've been increasing. It's not that somehow we're chasing customers harder and are less good. In fact, we're more focused actually on bringing in higher lifetime value customers.

Man 2:

Thank you. That makes sense. Just on the number of users, this might be disclosed somewhere, but what percentage of your total subscribers are in LatAm?

Vincent Litrico:

LATAM is less than 10 percent of the footprint.

Austin Lally:

Also, they're growing nicely. I'm also going to reinforce the point that we get good economics. We don't regard having this exposure in LATAM somehow as an exposure. We think that, actually, it's a growth factor for the company. I was with the Latin American team in November, went to visit the startup in Argentina, and was super happy to see more than 300 employees there. I think that we're actually going to bring something to the Argentinean market that isn't there. We had a very interesting meeting with the Buenos Aires mayor to talk about public security and the role that we could play. We went into the Brazilian market in 2013. We're now clearly the number-one player in the country. Brazil's now one of our largest portfolios, so very proud of the Latin American team.

Man 2:

Thank you. Lastly, when a customer moves house and they stay with Verisure, do you recognize that as attrition and a new installation or do you not recognize it?

Vincent Litrico:

No, we don't. This is an existing customer. It's basically neither in attrition nor in new sales.

Man 2:

Perfect, all right. Thank you very much.

Operator:

The next question comes from Ryan McElvenny from Man Group. Please go ahead.

Ryan McElvenny:

Hi, good afternoon. Thank you for taking my question and congratulations on the very strong results. I just had a more conceptual question, maybe to kick it off. In terms of the ARPU level, I'm just curious, where do you see this topping out? Have you looked at other markets? Do you have a sense if there's sort of an absolute cost level per month where it becomes difficult to go beyond?

Austin Lally:

Well, I think we'll learn that over time. Probably another way maybe to look at the question. I come from the consumer space. I had 25 years, as Vincent had in the consumer product space before moving into services. One of the things you learn in that world is that, generally, low penetration segments tend to have consistency in pricing. They can often end up with fairly high pricing. As penetration builds over time, it's not that you have a ceiling on pricing. It's that you may end up with some more segmentation in the market. I think the penetration levels are so low, honestly today, that that's a bit of a moot point on the security landscape. In reality, our average adds up to €43. If you compare that to the cost of your cable package, your fiber broadband, the entertainment package and so on, we think it represents fantastic value.

We've got customers that are paying well over €50 today. I think that the key to it is not some absolute price point. The key to it is content. It has really given the customer experiences and service that they think are great value for money. Our view on pricing has always been that you have to earn the pricing. Basically, more for more. I think so far, that has served as well. Obviously, we take it carefully. Like we're always looking for this triangle I mentioned before. We're not trying to maximize volume or maximize pricing. What we're trying to do is maximize long-term value creation. Pricing too aggressively when you don't have the content to justify it and you lose the volume makes no sense. Similarly, leaving a lot of value on the table because you don't have the courage to price that makes no sense.

Pricing has to be underpinned by content. Which is why I always come back to the innovation program. Also, to the great men and women that we have in technology. Again, it's often everyone remembering that we're not just a sales machine that resells other people's equipment. We have our own innovation stack. We've got our own large world-class engineering organization. They're working on propositions that justify this pricing.

Ryan McElvenny:

Absolutely. I think that makes sense. Maybe just on another point. This sort of goes against the idea of maximizing long-term value creation. It's just conceptually so that I understand the growth CapEx and the attrition along the curve. If you were to just cut the growth CapEx spends of 1.1 billion, given the attrition along the curve, would you expect annual topline decreases of six to seven percent per annum? Obviously, it's overly simplistic because you have levers and you can increase ARPU, but is that roughly, correct?

So, suppose you were just to cut the gross CapEx, basically the 1.1 billion. Then you would see the customer churn just continue to be six or seven percent per annum for the next several years, assuming you didn't increase ARPU. I just want to make sure I understand the growth CapEx figure and how that impacts the growth profile of the business, if you would, just to try to maximize cash generation.

Austin Lally:

I guess that's not our strategy, though. You can model the scenarios that you want. I'm not going to describe a scenario that doesn't actually fit with how we run the business. We take it as a given that we will only put growth CapEx to work if we actually think it's a really good use of capital. That means we've got to be sure that we're investing that growth CapEx in customers with a really good IRR. That's what we've been doing. That equation I gave you before, CLV minus CPA, that's really our mantra.

Now, obviously, if the company decided not to grow, for example, just to replace attrition, that would obviously give you some kind of theoretical, infinite cash flow. That's actually what we offer. That's what we call our own metrics on the business, like SSNOCF. It's steady state net operating cash flow. That tries to give you a simulation of an infinite cash flow. Certainly, I don't think anybody should say no to any sort of modeling where a company just decides to shrink by the attrition level every year.

Ryan McElvenny:

It's part of the maximization of long-term value creation. The business is doing fantastic. I was just trying to point out.

Austin Lally:

It's perfectly possible to model it. It's a scenario where you only replace the attrition. Then what you would have, of course, is this permanent portfolio of a certain size, generating this infinite set of cash flows for the future. You can put a value in that. That's what we call steady-state net operating cash flow.

Ryan McElvenny:

Perfect.

Austin Lally:

When I was in the consumer world, where we didn't really have recurring revenue the way Verisure thinks about it, nonrecurring revenue businesses, every year the clock resets to zero. These companies have to spend the vast majority of their year in rebuilding, recreating last year's revenue and EBITDA. What causes a big structural advantage for a recurring revenue business like ours with low attrition, is that with attrition at seven percent or so, every year in January, I start with maybe seven percent less revenue than the year before. Then I take some pricing. I continue to have good cost programs in the company. More importantly, I've got tens of thousands of salespeople who, on January 1, are not recreating last year's revenue

but actually brings in new customers. In the context of 2022, that was 200,000 new customers every quarter. I don't have to spend the year trying to recreate what we had. Very quickly, we get to grow. To me, that's part of the power of the engine. That's why it's not about a steady state or what happens if you don't grow. It would be a real waste of this incredible asset called my sales machine not to use it for growth.

Ryan McElvenny:

Absolutely. That's very clear. Thank you very much and looking forward to seeing you in the next quarter.

Operator:

There are no more questions at this time. I hand the conference back to the speakers for any closing comments.

Austin Lally:

Again, thank you all for participating today and, more importantly, for the continued support in our company.

The past 3 years have been complicated. 2 years in 2020 and 2021 when the pandemic was front and centre for families and small businesses in our footprint. And 2022 with inflation, war, a cost-of-living crisis and an approaching recession. These have certainly been serious and difficult times for many families.

And yet these 3 years have still been strong years of growth for Verisure. I am proud of our team and grateful for the trust so many families and small businesses have placed in us.

Our focus has been to help, because in our DNA, we are a peace of mind company. We contribute to the peace of mind of our customers by continuing to provide an excellent service 24/7. We think this is more important than ever. And we want to bring that peace of mind to even more customers. More customers. And serve them better.

In summary, our portfolio is robust. Our service levels remain high. Our new sales performance is strong. Our financial delivery is strong. We have delivered another quarter of strong operating and financial performance, and we have once again achieved new highs for portfolio and performance metrics. We will continue to leverage our unique strengths and assets to deliver differentiated value creation.

So again, many thanks for your interest and support and for the questions. We look forward to talking to you again next quarter to review how 2023 has started.

Well, thank you moderator. Again, I want to thank everybody for participating today. Also, for the wide range of questions, and for the continued support of the company.