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ChannelAdvisor Corp. (ECOM)

Q1 2022 Earnings Call

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CORPORATE PARTICIPANTS

Raiford Garrabrant
Director-Investor Relations, ChannelAdvisor Corp.

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.

Elizabeth Segovia
Chief Operating Officer, ChannelAdvisor Corp.

Richard F. Cornetta
Chief Financial Officer, ChannelAdvisor Corp.

OTHER PARTICIPANTS

Colin Alan Sebastian
Analyst, Robert W. Baird & Co., Inc.

Zach Cummins
Analyst, B. Riley Securities, Inc.

Matthew Pfau
Analyst, William Blair & Co. LLC

Tom Forte
Analyst, D.A. Davidson & Co.

Joshua Reilly
Analyst, Needham & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day and thank you for standing by. Welcome to the First Quarter 2022 ChannelAdvisor Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, there will be a question-and-answer session. [Operator Instructions]

I will now hand the conference over to your speaker today, Raiford Garrabrant, Head of Investor Relations. Please go ahead.

Raiford Garrabrant

Director-Investor Relations, ChannelAdvisor Corp.

Thank you, Victor, and good morning, everyone. Welcome to ChannelAdvisor's conference call for the first quarter of 2022. With me on the call today are David Spitz, ChannelAdvisor's Chief Executive Officer; Beth Segovia, ChannelAdvisor's Chief Operating Officer; and Rich Cornetta, ChannelAdvisor's Chief Financial Officer.

This morning, we issued a press release with details on our first quarter 2022 performance, as well as our outlook for the second quarter and full year 2022. This press release can be accessed on the Investor Relations section of our website at ir.channeladvisor.com. In addition, this call has being recorded and a replay will be available after the conclusion of the call.

During today's call, we will make statements related to our business that may be considered forward-looking under federal securities laws. These statements reflect our views only as of today and should not be considered representative of our views as of any subsequent date. We disclaim any obligation to update any forward-looking statements or outlook. These statements are subject to a variety of risks and uncertainties that could cause actual results to differ materially from expectations. These risks are summarized in the press release that we issued

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today. For a further discussion of material risks and other important factors that could affect our actual results, please refer to those contained in our most recent Form 10-K, as well as our other filings which are available on the SEC website at sec.gov.

During the course of today's call, we will refer to certain non-GAAP financial measures, all of which are reconciled in the press release that we issued today. We also provide a GAAP to non-GAAP reconciliation schedule in our supplemental financial presentation posted on the Investor Relations section of our website.

Finally, at times in our prepared comments or responses to analysts' questions, we may offer metrics that are incremental to our usual presentation to provide greater insight into the dynamics of our business or our quarterly results. Please be advised that we may or may not continue to provide this additional detail in the future.

With that, let me turn the call over to David.

David J. Spitz

Chief Executive Officer & Director, ChannelAdvisor Corp.

Thank you, Raiford. We once again delivered strong financial results in the first quarter with revenue at the high end of our guidance range and adjusted EBITDA that exceeded the high end of our guidance range. Subscription revenue was particularly strong, increasing 17% year-on-year. This is a direct result of our brands' focused strategy coupled with consistent, solid execution. I'd like to now share a few of the highlights that keep us bullish about our long term prospects and confidence that we can achieve our 2025 targets of $250 million in revenue and $50 million in adjusted EBITDA.

First, our focus on brands continued to pay off with first quarter revenue from brands up 32% year-on-year to 45% of our total revenue and an all-time high of 49% of our subscription revenue. We're fast approaching the tipping point where the majority of our revenues will come from brands. Because brands are generally stickier and offer greater potential for expansion, we believe the superior unit economics we've enjoyed with brands will continue to benefit our results as they grow to represent a higher percentage of our business.

Second, our strong overall subscription revenue growth helped drive total revenue to the high end of our guidance range, despite slowing e-commerce growth and a more challenging macro environment as we move beyond COVID. We view this as a testament to the durability of our revenue model. Importantly, we expect our year-on-year revenue growth to bottom out in Q2, as we finish lapping those tough year-on-year comps in the quarter, and expect stronger growth in the back half of the year as the comps ease.

In fact, but for the significant strengthening of the dollar in recent weeks, we would have expected a return to double-digit growth in the back half of the year, and for the full year. Third, we've continued to deliver strong value to our customers through ongoing investments in our platform. Our expanding breadth of supported channels has continued to differentiate us, and that's why we maintained our rapid pace of channel expansion in Q1. And we now support over 340 channels globally, including Saks which I anticipate has the potential to be a significant channel for our customers.

Long tail GMV in aggregate was again larger than eBay and Walmart for us, second only to Amazon and grew much faster than all three. Additionally, Zalando, the fast growing European marketplace you've heard us mention before was our third largest channel for the first time, surpassing Walmart. In addition, Beth will speak to some of the many product innovations we've recently rolled out.

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Fourth, cash generation remained strong in Q1, with cash up $6 million quarter-on-quarter to $107 million total. Our pristine and debt-free balance sheet and attractive returns on invested capital have allowed us to make significant investments while still delivering strong profitability and robust cash flows. Although we continue to evaluate opportunities to deploy our excess capital, we remain committed to a financially disciplined approach, and focus on opportunities where we believe the potential returns align with our objectives.

In closing, even as e-commerce growth rates normalize following a remarkable couple of years of pandemic driven growth, our outlook remains strong, and we are well-positioned to drive continued profitable growth.

And with that, I'll turn it over to Beth.

Elizabeth Segovia

Chief Operating Officer, ChannelAdvisor Corp.

Thank you, David, and good morning everyone. Enabling brands to accelerate digital transformation and achieve their e-commerce objectives remained our priority, and we kept the momentum going in Q1. Coming off of a strong holiday season in Q4, we hit the ground running in 2022.

To start, our account managers worked with our clients to update their specific plans for expansion and growth this year. Also, we recently conducted our semi-annual employee engagement survey. 84% of our staff participated and we are so proud to say that employee satisfaction improved again to a record high in our company history and well above industry benchmark. Finally, we delivered significant advancements in terms of product capabilities, access to channels and industry leadership. And now, I'd like to walk you through this in a little more detail.

On the product innovation front, brands are actively seeking ways to streamline their e-commerce operations across the entire customer journey, whether it's how they promote their products, drive traffic to preferred retailers or even how they process orders across channel. ChannelAdvisor's spring release gives them more ways to do that with an array of platform enhancements, partnerships and integrations that will help brands scale and optimize their marketing, selling and fulfillment operations all from a single interface.

One of our top innovation priorities is to make it easier for our customers to reach more consumers by expanding our breadth of supported channels. Last year, we committed to adding at least 80 new integrations by mid-2022 compared to where we were at the end of 2020. As a result of terrific execution by the team, we exceeded that goal nearly six months early in January and are planning to add channels at a similar rate again in 2022.

We got off to a fast start in Q1, adding integrations for 21 new marketplaces, including Walmart Mexico, Spartoo in 17 new European locales, Linio in Mexico and Chile, and another 5 locales for AliExpress, as well as two new first-party dropship connections with Douglas in Germany and Austria. With the addition of these new channels, ChannelAdvisor now provides our customers access to over 340 marketplaces and retail integrations. We also made it easier for brands to automate the creation of high-quality product content by adding support for Amazon vendor content in 12 new locales, bringing the total to 19 third parties and 21 first-party locales.

Success in multichannel commerce relies on more than just having a listing on a given channel. Our strategy is to go deep on key channels and enable our clients to leverage native capabilities such as fulfillment and advertising. With our latest product release, ChannelAdvisor expands our fulfillment support by providing sellers the ability to manage and automate their fulfillment operations across additional channels, including Bol.com and Wayfair. With these additional fulfillment integrations, sellers can deliver the best on-channel consumer experience, while maintaining flexibility over fulfillment options based on product selection and inventory availability.

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On the advertising front, we've recently established an API partnership with Criteo to expand retail media advertising opportunities for our customers. These capabilities should be available midyear. ChannelAdvisor also released managed services for advertising on TikTok. TikTok is increasingly used by brands and retailers to reach new audiences.

Continuous product innovations like these have contributed to cementing our position as the leading multi-channel commerce platform for e-commerce. Last quarter, we mentioned that we were named the number one channel management vendor by Digital Commerce 360 for the 10th consecutive year. And this quarter, I'm pleased to say we again achieved Premier Partner status for 2022 in a Google partners program under more exclusive criteria this year, joining a prestigious list that showcases the top 3% of Google partners in the US. As a Premier Partner, ChannelAdvisor has access to the training and insights needed to help brands drive long-term growth, and stay ahead of the fast changing e-commerce landscape.

To see a case study that ties this all together, please visit our website to learn more about our customer , a leading provider of high-quality equestrian tech, apparel, and home decor. Until May of 2020, AJ Tack was using the ChannelAdvisor platform to reach marketplaces like Amazon, Walmart, and eBay, while a third firm managed its Google Ads. But when a new ownership team came on board, they recognized the advantage of consolidating on one platform by utilizing ChannelAdvisor for both marketplaces and digital marketing. By working closely with a client strategy manager who focuses specifically on Google Ads, AJ Tack exceeded expectations with a 44% year-on-year increase in conversions for Q4, and an 85% revenue increase during the same quarter.

They also leveraged ChannelAdvisor's repricing solutions that automatically respond to shifts in demand noting that, "once we put the repricer in place, we saw results from it almost immediately." By partnering with ChannelAdvisor, AJ Tack captured the Amazon buybacks more frequently. In their words, if brands are selling on multiple platforms and need easy one-stop-shop support, channel advisor is great.

Our momentum in landing new brand customers was evident through the addition of new customers such as Perry Ellis, Interparfum and Ste. Michelle Wine. And David mentioned earlier our strategic partner, Saks. In terms of growing our business with existing customers, our account managers collaborated with our sales team to sign expansions with customers like Lacoste, Epson and Wolverine Worldwide.

To summarize, our platform approach is resonating with brands. In Q1, we continue to build on the progress we made in 2021, and there are numerous initiatives underway to keep the momentum going. By empowering brands to reach new customers, promote their product offerings, and streamline operations globally, ChannelAdvisor continues to be well-positioned to capitalize on the positive long-term trends in our industry.

With that, I'll pass it to Rich now to provide a more detailed update on our financial performance. Rich?

Richard F. Cornetta

Chief Financial Officer, ChannelAdvisor Corp.

Thanks, Beth, and good morning, everyone. We entered the first quarter of 2022 coming off a year of record top line results, robust subscription revenue growth, and strong adjusted EBITDA and cash generation, driven by the strategic investments we have made over the past 18 months. Our outlook for Q1 anticipate continued strong subscription revenue growth in the mid-teens, and also acknowledge some challenging year-over-year variable revenue comps that we expect to continue into Q2.

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I'm pleased to report that our results for the first quarter of 2022 came in better than expected, with revenue at the high end of the guidance range, subscription revenue growth of 17%, and adjusted EBITDA that exceeded the high end of the guidance range. At the same time, we continued to achieve strong cash generation and healthy margins, even with our growth investments.

So let's get into the details for Q1. Total revenue reached $42.3 million in the first quarter, up 8% year-over-year, driven by subscription revenue performance, which reached another record at $35.5 million and matched the 17% year-over-year growth we achieved last year. And variable revenue of $6.8 million was in line with what we factored into our Q1 outlook. Revenue results associated with our brands cohort remained solid during Q1. We achieved total revenue of $18.8 million, up 32% year-over-year. More importantly, we realized record brand subscription revenue of $17.3 million during Q1, growing 36% over last year, and representing 49% of our total subscription revenue, also a new record. This is up roughly 700 basis points from the prior year period.

Brands customer account and average revenue per brands customer continued to increase throughout the quarter. And our strong revenue retention is driven by the strategic cohort of customers. Our fastest growing revenue cohort continues to be customers with ARR greater than $100,000, and these customers represent the majority of our ARR. Given all of these factors, we continue to expect that a majority of our revenue will come from brands by the end of 2022.

Now, moving on to adjusted EBITDA. We finished Q1 at $8.2 million, well ahead of the high end of our outlook of $7.2 million, generating an adjusted EBITDA margin of 19%. The adjusted EBITDA over-performance was primarily driven by the pace of hiring, as well as the benefit from lease abandonment, which we'll continue to assess across our global footprint throughout the year. While still maintaining healthy margins, we remained biased towards growth, and operating expenses have been building steadily over the last year as we made strategic investments in our product and our services and sales organizations.

As mentioned earlier, we had another terrific quarter of cash generation during Q1, with cash and cash equivalents reaching approximately $107 million and representing an increase of more than $6 million sequentially and $25 million year-over-year. Operating and free cash flow remained very healthy again in Q1, coming in at $7.9 million and $6 million, respectively. We also saw deferred revenue increase again during Q1 to record levels of $6 million year-over-year.

Now, on to our financial outlook. For the second quarter of 2022, we're providing a revenue outlook range of between $42.5 million and $43 million, an adjusted EBITDA range of between $7.2 million and $7.6 million. As David mentioned earlier, the strengthening of the dollar over the last few weeks has had a meaningful impact on our financial outlook, lowering our year-over-year growth rate for Q2 by over 3 percentage points.

With respect to subscription revenue, we expect continued strength in Q2 and our outlook reflects anticipated subscription revenue growth in the low-to-mid teens. If not for the FX headwinds, our expected subscription revenue growth would be at least mid-teens. We anticipate variable revenue to decline year-over-year, similar to what we saw in the first quarter, and primarily a result of the difficult comps due to stimulus-aided tailwinds a year ago, and because customers have been trading up to higher tiers over the past year, which benefits our subscription revenue. In addition, Amazon Prime Day was held in June of last year, driving higher variable revenue in Q2 2021.

So despite the recent volatility we've seen with respect to currency, we will provide a financial outlook for the remainder of the year. This is due to the good visibility we have with respect to subscription revenue, coupled with the normalization we expect to see for variable revenue in the back half of the year. We believe future revenue

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growth will be the low point, even excluding the impact of FX as we finally left the effects of COVID and stimulus tailwinds from last year.

So, for the full year, we target revenue to be in the range of $177 million to $180 million, and adjusted EBITDA in the range of $37 million to $39 million. On a constant currency basis, our outlook would have resulted in a return to double-digit growth in the back half of the year, as well as for the full year.

We anticipate full-year subscription revenue growth to be in the low-to-mid teens on top of the significant subscription revenue growth rates achieved in 2021. On a constant currency basis, our expected subscription revenue growth outlook would be at least in the mid-teens.

So, in closing, our strategic focus remains with brands, and we are encouraged by the growth rate we have seen in subscription revenue. We will remain judicious with our cash on hand, and we will only pursue investments that supports our brand strategy and that we believe have the potential to provide an ROI that exceeds our weighted average cost of capital. We appreciate the continued support of all of our stakeholders.

With that, operator, we'd like to now open the call to questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Our first question comes from the line of Colin Sebastian from Baird. Your line is open.

Colin Alan Sebastian Q
Analyst, Robert W. Baird & Co., Inc.

Great. Thanks. And good morning, everybody. I have a couple of questions here. I guess, first, maybe, David, a little bit more on the macro environment. I think we've seen the spectrum from results thus far. Amazon has said there's been really no impact on their business. We've seen certainly other companies indicate there's been a strong headwind in Europe ,if not globally. So, I was hoping you could kind of drill down on that a little. Is what you're seeing channel specific? What did you see from a linearity perspective during the quarter and through April, if you could provide a little more detail on that? And I have a follow-up. Thanks.

David J. Spitz A
Chief Executive Officer & Director, ChannelAdvisor Corp.

Sure. Thanks, Colin. Yeah. So, obviously, we saw a moderation in GMV compared to in the middle of the pandemic. And I will remind everybody that last March, we had a – I think the largest stimulus check in the US, that was issued during the pandemic. And so, I've referred to those previously as Amazon stimulus checks, because we can sort of see on our dashboards the day those things get sent out and deposited, spike in GMV. So, we're comping against that in particular in March.

And so what we saw from a trend perspective is probably the low watermark in terms of GMV was right around mid-March, mid-to-late March coinciding with last year's stimulus check, making that a tough comp. But we saw it creep back up towards the end of March and saw that trend continue in April. So, I think in large part, you're looking at a stimulus comp that created a little bit of a bubble last year that obviously wasn't repeated this year.

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Beyond that, it's – I'm speculating, of course, but I think that inflation, you'd have to be crazy to not think that that has some effect on consumer discretionary spending, when gas is $4, $5, $6 a gallon depending on where you live. And so, I expect that probably has weighed a little bit on discretionary spending as well.

But I would say, the patterns were fairly consistent. I would not say that they were necessarily channel specific. If you look at our charts, the things that I look at internally, all the lines sort of followed, similar trajectories over the course of Q1 and into April.

Colin Alan Sebastian
Analyst, Robert W. Baird & Co., Inc.
Q

Great. That's helpful. And I wanted to drill down a little bit on the brand subscription ARPU or ARPC, the sort of ongoing increase there, can you kind of walk through the drivers of that increase and how high you think that could ultimately go, sort of on an apples-to-apples basis?

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.
A

I'll give you some qualitative assessment. Then, Rich, if you've got something to add, feel free to join in. One of the nice things about brands is that they can really use the entirety of our platform, right? So we have obviously, we're best known for our marketplace integrations, but we're also the first and we also offer first-party dropship, digital marketing, retail media, shopping analytics, Shoppable Media, right, we have a wide range of capabilities. And 99 times out of 100, when we initiate a relationship with a brand, they are starting with one particular solution because they're trying to solve an acute need.

But over time, they see lots of opportunity to expand with us. They could be adding additional products, they could be expanding channels, they could be growing into other geographies. Many of the brand customers we work with actually have a multitude of brands, so we might start with one product line and then expand it to other product lines. So all of those things contribute to a pretty significant expansion opportunity for brands.

One of the things that we said at our Analyst Day is that we felt that just on our existing customer base alone, we could roughly quintuple our revenue. Meaning at the time that we did our Analyst Day, I think, we were at about $50 million in revenue from brands and we felt the addressable market or share of wallet within our brand customers that we already have, was at least $250 million. So obviously, we're also focused on adding additional logos as time progresses. But the expansion opportunity with brands is pretty significant and remains an important focus for us.

Richard F. Cornetta
Chief Financial Officer, ChannelAdvisor Corp.
A

Yeah. The only thing I'll add there, Colin is, I mentioned in our prepared remarks that the fastest growing revenue cohort are our customers with ARR greater than $100,000 and that's driven by our brands focus. So just to put some numbers behind that, that sight or how our brands – our focus on brands customers there. And also with regards to net revenue retention, we mentioned at Analyst Day over 100%, again driven by our brands focus there. So just to put some numbers behind David's statements.

Colin Alan Sebastian
Analyst, Robert W. Baird & Co., Inc.
Q

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Thanks. And just to clarify, when you – beyond sort of the size of the brand, in terms of monetization growth or pricing, is part of the expectation that you'll be able to drive higher pricing as brands are adopting more of these services?

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.

A

Yeah. There's a few different ways we can grow, right? So if they're adding additional products from our platform or expanding to new geographies or additional product lines that they have, certainly we – those come at a price, right? So we charge for those various services. And, of course, I neglected to mention the just growth itself. So as brands join our platform and they sell more and they grow GMV, that's also another growth factor for us. But yeah, in virtually all cases, there's an opportunity to monetize that expansion, which is why you're seeing that expansion in – significant contributor to the expansion of subscription revenue we have with brands.

Colin Alan Sebastian
Analyst, Robert W. Baird & Co., Inc.

Q

Thank you.

Richard F. Cornetta
Chief Financial Officer, ChannelAdvisor Corp.

A

One other thing to add there also is that our brands customers tend to be more managed customers. So that also is a driver of higher average revenue per customer. They're utilizing our e-commerce experts every day to advance their e-commerce objectives. And they pay a premium for that.

Colin Alan Sebastian
Analyst, Robert W. Baird & Co., Inc.

Q

Thanks,

Operator: Our next question will come from the line of Zach Cummins from B. Riley Securities. Your line is open.

Zach Cummins
Analyst, B. Riley Securities, Inc.

Q

Hi. Good morning. Thanks for taking my questions. First one for me, Rich, can you talk about some of the currency assumptions you're making here in the Q2 guidance and kind of what's being baked into that full-year outlook as well?

Richard F. Cornetta
Chief Financial Officer, ChannelAdvisor Corp.

A

Yeah. It's pretty remarkable what we've seen just in the last two weeks for that matter. We have updated our forecast a couple of weeks ago and then made a few adjustments more recently, and it was really surprising to us how much of an impact it had on Q2, let alone the rest of the year.

We mentioned in Q2, roughly a 3-point impact which essentially if not for FX, we would be right in line with current consensus for Q2. For the remainder of the year, we could see anywhere between a 4 point to 5 point impact as a result of FX. And that's what's baked into our current model.

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Zach Cummins
Analyst, B. Riley Securities, Inc.

Q

Understood. That's helpful. And in terms of the investments, I know for the last probably year-plus, you've really been working to build out sort of the sales force and then investing in new product innovations. Can you talk about where you're at with the sales force at this juncture in terms of having enough, I guess, quarter carrying capacity to be able to sufficiently meet the demand that's in front of you?

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.

A

Yeah. Zach. This is David. We're really pleased. So we came into the year, you may recall, with a bit of a gap there on sales capacity. And we've worked really hard over the course the last four months to address that. And I would say, we are very close to completely closing the gap. We're actually trying to hire to a year-end target. And so we're just a few head count short of that, and I anticipate that by the end of Q2, we should have that fully resolved, and hopefully with a little bit of luck, maybe actually over-hire a little bit to create some bench. But we made strong progress in the quarter and into April on that front.

Zach Cummins
Analyst, B. Riley Securities, Inc.

Q

Understood. That's helpful. And final question geared towards that. Can you talk a little bit about, I guess the marketplace expansion strategy? It seems to be pacing well ahead of expectations from the initial targets that were put out there. I mean, has there been any sort of key theme in terms of specific regions or specific marketplaces that majority of your brands customers have been interested in breaking into?

Elizabeth Segovia
Chief Operating Officer, ChannelAdvisor Corp.

A

Thanks for the question. I think it's a good one. I think, you're right on the money in that we focus on what our clients are looking to do in terms of specific expansion. There is still quite a bit of opportunity across Europe as well as a lot of emerging opportunity in Asia Pacific. So I would say, the expansion efforts have certainly been weighted strongly in those regions. We've certainly added channels in the United States and continue to do so. But the majority of our activity over the last year has been really focused on European and Asia Pacific marketplaces.

In integrations, we've also seen a lot of activity in the 1P space, which has driven a lot of connections. So, beyond that we have a wide variety of customers and they're focused on a number of different things. And that's what's pretty cool actually about marketplaces, is that they're focus on specific areas or specific product categories. And so, as our customers focus on building out their footprint, we follow suit. So, we just tend to focus on where the market is going in terms of new and emerging marketplaces and where customers are trying to reach more consumers.

Zach Cummins
Analyst, B. Riley Securities, Inc.

Q

Got it. That's helpful. Well, thanks for taking my questions and best of luck for the rest of the quarter.

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.

A

Thanks, Zach.

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Operator: Our next question comes from the line of Matt Pfau from William Blair. Your line is open.

Matthew Pfau
Analyst, William Blair & Co. LLC

Q

Great. Thanks for taking my questions, guys. Just wanted to ask on – in terms of the demand environment, so obviously, there's some impact here on the variable revenue from the GMV front. But in terms of what you're seeing with bookings relative to either new customers or expansions with the existing customers, is that impacted at all by some of the normalization of e-commerce, or how does that continue the momentum that you guys have been seeing?

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.

A

Hey, Matt. Yeah, I think the demand environment remain strong. Obviously during COVID, there were a number of companies that went into high gear in terms of their digital transformation and that was that was helpful to us, but there are many, many companies that are finally getting to the point where they can address these things, right? They spent the last year or two kind of more in [ph] 3 hours mode (30:21) where they were dealing with either supply chain or fulfillment or staffing, all those kinds of things. And so, I would say, the demand environment remain strong.

Matthew Pfau
Analyst, William Blair & Co. LLC

Q

Got you. And I think, part of the – some of the initiatives Beth has done with her team is sort of being more strategic with some of the enterprise clients that you have and maybe sort of thinking about longer term road maps that they have, is – any change in, I guess, what you're hearing from customers in terms of their longer term plans relative to either marketplace expansion or e-commerce in general?

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.

A

I'll have Beth comment on that. But I would say at a high level, I don't really see any change. I think, nobody expected e-commerce growth rates during COVID to continue indefinitely, trees don't grow to sky per se, but everybody understands the continuously increasing importance of e-commerce. The probability that it's got a lot of room to grow in terms of share of wallet, and it's not just the growth of e-commerce for brands, it's also about their transformation to get closer to the consumer. If we look at other instructive industries, like just look at the media industry, right, nobody is placing bets on blockbuster video anymore, right? It's all about content owners getting closer to the consumer. It's – the Internet has a way of compressing the distance between producers and consumers.

And so, in e-commerce, it's really not any different. And brands who have proprietary products recognize that the path to the consumer is shifting rapidly and in many cases, means they have to get closer to how they reach that consumer. So that's the long term kind of fundamental, secular dynamic that is changing a lot of behavior on top of just the overall long-term growth of e-commerce. And Beth, I don't know if you had anything you want to add, just around sort of the customer commentary or the road map.

Elizabeth Segovia
Chief Operating Officer, ChannelAdvisor Corp.

A

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Yeah. I mean, I would say, steady as she goes, right? So we certainly saw an acceleration of interest and activity and commitment from brands as they realized the digital transformation just needed to move more quickly. But I would say, these efforts are tremendous and time-consuming. So, as brands look to grow their direct-to-consumer businesses, expand on marketplaces, build out their fulfillment capabilities, these things take time. And depending on their global footprint and how many countries they want to do that with and how many brands, it takes a consistent and steady effort.

And so, while significant progress was made last year and we've expanded channels to meet and lead that demand, there's much more progress that has yet to be made. So we are continuing to invest in our enterprise level of service. We're continuing to apply those new resources to enable those customers, to execute those expansion plans. And as I mentioned, every year we go through an annual planning exercise and we really focus on, so what are we doing this year and what's the quarter-by-quarter plan and how many new channels are we going to bring on board. And so, we are in execution mode, and I would expect that's going to go on for multiple years with our existing clients. And then as we acquire new logos, we'll start the process again with them.

Matthew Pfau
Analyst, William Blair & Co. LLC

Q

Great. And just one more for me on the Commerce Network, maybe just an update of those efforts and what you're seeing there.

Elizabeth Segovia
Chief Operating Officer, ChannelAdvisor Corp.

A

Sure. I'll take that one. So the Commerce Network is going well. So we have – that's our capability that brings both sides of our networks together. So it gives our partners an opportunity to log-in to our software on a regular basis to seek out and find new retail and brand sellers to bring to market. And it also enables our customers obviously, to find more channels to go-to-market on. And so, this network creates a matchmaking opportunity and expansion opportunity for both sides of that network.

And I would say we've seen steady engagement, we saw some very nice engagement as we went through Q1 as the heat of Q4 and execution sort of died down a little bit. And our customers and our partners started focusing on the plans for the year. We saw a lot of profile sharing and a lot of engagement happening. We've seen an uptick in our partner profile, creation and sharing. And so, I think it's a steady as she goes. We are nurturing the platform. We're continuing to plan for and release new capabilities throughout this year and the road map goes into next year as well. So you'll hear us talk about it more as we give you updates in the future, but it's going as planned. Thank you.

Matthew Pfau
Analyst, William Blair & Co. LLC

Q

Great. Thanks, guys. Appreciate it.

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.

A

Thanks, Matt.

Operator: [Operator Instructions] Our next question will come from the line of Thomas Forte from D.A. Davidson. You may begin.

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Tom Forte
Analyst, D.A. Davidson & Co.

Q

Great. Thank you for taking my questions. I have three. So, the first one, David, you talked about inflation at the e-commerce level, I'd like to know about inflation at the ChannelAdvisor level. How are you managing it, including labor inflation?

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.

A

Hey, Tom. Thanks. Yeah, so our merit increase for the year for our employees was significantly higher than we would normally do in a year. I believe it was more than 2x kind of the normal annual increase as we work to keep up with the market and make sure that we're being thoughtful and standing by our employees. So that's been a part of it. We also kicked off a pricing increase at the beginning of Q2 and so we increased our price book. And obviously, that'll take time to work through our entire customer base. But we view that as helping to offset, at least partially offset, some of the increases in wages that we've seen.

Tom Forte
Analyst, D.A. Davidson & Co.

Q

Great. And then my second question, and I have one more after this one, so I wanted to get your thoughts on the e-commerce industry and the impact for two items. One, discretionary spending, returning to travel, seen some companies talk about that, and then the second, Apple's emphasis on privacy affecting the efficacy of digital advertising.

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.

A

Yeah. I'll start with the first – or excuse me, the second around privacy. I think that's a trend that's just going to keep going, right, whether it's pressure from Apple, maybe from Google in some of their app policies and also on the regulatory front, right? I don't see an environment where privacy considerations don't get more stringent over time. And so, for us, I think it's actually been a bit of a tailwind. We don't use cross-channel cookies, we're not trying to track users across channels.

And what this has really done, in my view, is this has taken what has historically been kind of a duopoly between Facebook and Google and kind of cracked it open. So, retail media is one of the fastest-growing segments for us. That's, things like Amazon advertising or any of the advertising programs that exist across different retail sites. And our strategic partnership with Criteo is going to help us attach to a much broader set of those.

So, privacy, I think, is actually driving an intense desire to have more first-party data and to – and creating an opportunity for these sites to monetize more directly. So, I think net-net, it's a benefit for us and probably continue to add dollar shift from again, some of the some of the traditional behemoths to more dedicated sites.

To your first question about inflation and discretionary spending and travel, I'm not a macro economist, but I do think the consumer remains healthy. We're obviously in a uncertain environment as it relates to increases in interest rates, what that does and does the economy sort of have a soft landing or did it slow down abruptly. I saw that the jobs report just came out and it was really pretty strong. That's probably a lagging indicator. You're starting to see unprofitable companies and start-ups contemplate layoffs. So, maybe that's the canary in the coal mine. But as I said, in response to an earlier question, I think it's hard to imagine that with the fuel prices the way they are, with food price – when you look at the basics, right, the necessities, food, fuel, energy, those costs have gone up pretty substantially. And while I think the consumer is pretty strong, you have to believe that that has

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some impact on discretionary spending. Travel, I do think that there's a lot of pent-up demand to sort of get out of the house and go somewhere. Whether that's a meaningful impact on discretionary spending, I don't know.

But our view, the way we look at the rest of the year is that we think first quarter and at least the first part of second quarter, are kind of the toughest comps, again because of stimulus checks. A year ago, we had the child tax credit that was going out on a monthly basis for a period of time. And that's going away and you have inflation, so – but we expect the comps to ease and for GMV growth to be moderate and sort of normalize in the back half of the year. We have Prime Day, that's another point, right? I think Richmond in his comments that last year Prime Day was in Q2, this year it's scheduled for July. So that's Q3. So that will be a pretty interesting moment to see how Prime Day compares year-over-year. But believe, we think the back half of the year looks a little bit more normal compared to the first half of the year.

Richard F. Cornetta
Chief Financial Officer, ChannelAdvisor Corp.
A

And Tom...

[indiscernible] (40:50)

Richard F. Cornetta
Chief Financial Officer, ChannelAdvisor Corp.
A

Tom, sorry to interrupt. So, just one thing to add, specific to financial modeling, when you mention travel, we are anticipating some increased travel in the back half of the year as well as in 2023, almost a return to previous levels. So there are some additional expenses to be incurred as more economies open up and then travel has become more acceptable, to factor that into your financial models.

Tom Forte
Analyst, D.A. Davidson & Co.
Q

Excellent. All right. So my third question is almost like a case study. David, you said something that I thought was remarkable on Zalando. They're now to number three spot ahead of Walmart. So is that because we've hit some sort of inflection point for e-commerce penetration for apparel in European markets, or is it because maybe Walmart is emphasizing grocery, but if you were to step back, what's enabled Zalando to achieve the three spot on your GMV list?

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.
A

Yeah. I think, it's probably a couple of things. I think Walmart, during the course of the pandemic – so all of these products when you do, when you go to one of these sites they're typically showing up as a result of some kind of search. And I think Walmart shifted some of the emphasis towards first party products, right, because if you think about what people were buying online, it tended to be consumer staples and stuff like that. So, I think, most of our exposure is to marketplace. And I think there was a little bit of a shift towards 1P. And so, that's another thing that I think will lap against in Q1 and Q2 that should dissipate from a year-on-year perspective.

But putting that aside for a moment, I think Zalando, probably the – so for those who aren't familiar, it's a European, they're based in Germany, it's a European fashion retailer or fashion marketplace. And I think one of the things that Zalando has done very well that other marketplaces haven't necessarily done is they really work closely with their brands to help with storytelling. And it's not just like everybody gets the sort of same format, one

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picture kind of transactional [indiscernible] (43:05). Because it's so focused on fashion, it really provides more of a storytelling type of environment.

And they've done a fantastic job rolling out fulfillment services and continue to establish themselves as – and one of the things I have said in the past is that the way to compete in the space isn't necessarily to go and be the next big general merchandise marketplace, it's to go, be a winner in a specific category because every category has different shopping characteristics. If you think about how automotive is, right? So automotive is very geared towards make model a year, which we call fitment. And how-to videos and community. Fashion, obviously is much more image and video-based. And so, you can build sort of category-specific experiences that are really compelling compared to sort of general merchandise marketplaces.

So I think Zalando has just, frankly executed really well. We've had a great partnership with them. I know they view ChannelAdvisor as a strategic partner, because we were able to bring those brands on not only quickly, but with high-quality integration that ultimately translates to a good consumer experience, which is important for everyone. And so, we've enjoyed a very fruitful relationship with them. And I anticipate it'll continue to grow nicely for us.

Tom Forte
Analyst, D.A. Davidson & Co.
Q

Great. Thanks, David. Thanks, Rich. Thanks, Beth.

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.
A

Thanks, Tom.

Operator: And our final question will come from the line of Josh Reilly from Needham. Your line is open.

Joshua Reilly
Analyst, Needham & Co. LLC
Q

Hey, guys. Thanks for taking my questions. Nice job on execution here in the quarter in a challenging macro. I'm going to throw another macro question out here. How much of a divergence and trends are you seeing between the US and Europe and maybe the rest of the world since the war in Ukraine has started? Are you seeing Europe slow e-commerce trend significantly faster than the US or is it closer to parity?

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.
A

Yeah. It's an interesting question, and I actually have to go back and rerun some of my analysis, because frankly the biggest impact right now is, as Rich said, currency, right? So we have fairly meaningful exposure to the British pound and to the euro. And if you just look at a chart over the last couple of weeks of April, you'll see that the unusually rapid strengthening of the dollar compared to what you would normally see during most two to three week periods. And so, we've seen that that's actually the biggest impact. And so, I need to go back and sort of reparse, neutralizing the effects of currency.

But I would say, just from a demand perspective, we continue to see strong demand in Europe. I think a lot of that is predicated on a lot of the work we've done around products. So that was leading to some of the channel expansion opportunities that we've had and a good bit of that is based on Europe. Europe is more fragmented from an e-commerce perspective, so the more we sort of cover that fragmented space, the more attractive we are

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to those who want to sell in Europe. So, thus far, I would not say that the – I can tell you that we've seen a meaningful decline and I suspect that once we adjust for currency, I would say it's actually a pretty strong area for us at this point.

Now we don't have a significant exposure, at least directly to Eastern Europe at this point. So most of our exposure is UK, Germany, and then from there probably, France, Spain, Italy, maybe Netherlands. So I don't think at least from a direct standpoint that that we're seeing a meaningful impact at this point anyway.

Joshua Reilly
Analyst, Needham & Co. LLC
Q

Got it. That's helpful. And then maybe just one on gross margins. Given the lower variable revenue here, how should we think about gross margins throughout the rest of the year? And with products like Shoppable Media and brand analytics, which as we know, are not based on GMV, offsetting the variable headwind to gross margin.

Richard F. Cornetta
Chief Financial Officer, ChannelAdvisor Corp.
A

Yeah. Obviously, some of the success we saw with our margins over the last couple of years and continue to see even further now, was driven by variable revenue. And we said that most variable revenue falls right to the bottom line. We continue to focus on things we can control, which is subscription revenue, and again as I mentioned, 17% growth in Q1. There is no – with regards to gross margin, we've made investments there in support of our customer base. You should expect some normalization in our COGS line and gross profit in the back half of the year as the investments start contributing to expansion opportunities with our brands customers' base.

But if you see over the last couple of quarters, there has been some deceleration in COGS – in gross margin – I'm sorry, in the COGS line. And I just think that there's a lot of opportunity there to expand our relationships with our customers through this investment. And we'll see some top line benefit in the future.

Joshua Reilly
Analyst, Needham & Co. LLC
Q

Got it. Thanks, guys.

David J. Spitz
Chief Executive Officer & Director, ChannelAdvisor Corp.
A

Thanks, Josh.

Operator: Thank you. I'm showing no further questions in the queue. I'd like to turn the call back over to Raiford for any closing remarks.

Raiford Garrabrant
Director-Investor Relations, ChannelAdvisor Corp.

Thanks, Victor, and thank you everyone, for joining us today. We look forward to speaking with you again soon.

Operator: And this concludes today's conference call. Thank you for participating. You may now disconnect, and have a good day.

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