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Vivint Smart Home, Inc. (VVNT)

Q1 2021 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to the Vivint Smart Home First Quarter 2021 Earnings Call. This time, all participants are in a listen-only mode. After the speakers' presentation, there'll be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I'll now like to hand the conference over to Nate Stubbs Investor Relations. Please go ahead.

Nate Stubbs

Vice President-Investor Relations, Vivint Smart Home, Inc.

Good afternoon, everyone. Thank you for joining us to discuss the results of Vivint Smart Home for the three months ended March 31 2021. Joining me on the conference call is Todd Pedersen, CEO; and Dale R. Gerard, CFO.

I would like to begin by reminding everyone that today's discussions may contain forward-looking statements, including with regards to the company's future performance and prospects. Forward-looking statements are inherently subject to risks, uncertainties and assumptions and are not guarantees of performance, and you should not put undue reliance on these statements. I would direct your attention to the risk factors detailed in the amendment to our annual report on Form 10-K/A for the year ended December 31, 2020 which we filed with the Securities and Exchange Commission on May 11, 2021.

Please be aware that these risk factors may be updated from time-to-time in the company's periodic filings with the Securities and Exchange Commission and that the realization of any such factors could affect our future results and could cause those results or other outcomes to differ materially from those expressed or implied in our forward-looking statements. The company undertakes no obligation to update or revise publicly any forward-looking statements whether as a result of new information, future events or otherwise.

During today's call, management will also refer to certain non-GAAP financial measures. Reconciliation of these non-GAAP financial measures for historical periods to the most comparable measures calculated and presented in accordance with GAAP are available in the earnings release and accompanying presentation, which are available on the Investor Relations website at investors.vivint.com.

I will now turn the call over to Todd.

Todd R. Pedersen

Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

Thanks, Nate, and good afternoon to everyone. I hope that life is starting to get back to normal for all of you as vaccine rollouts accelerate and total case counts decline. Today, we will cover the following topics: discuss our strong financial and operating results for the quarter, review our robust customer engagement and the performance of our platform, talk about our excitement over the near-term outlook for Vivint's premier end-to-end smart home platform, as we gear up for what we expect to be a normal summer selling season and as our customers engagement levels remain high regardless of whether people are spending time inside or outside their homes.

The momentum around our business that we saw in 2020 has carried into the first quarter of 2021 and we are pleased to report continued improvements in our key metrics year-over-year, including an accelerated revenue growth of 13%, along with 60,000 new smart home originations, which represented a 20% increase, all while producing an adjusted EBITDA margin of 47%. As of March 31, 2021, Vivint's total subscribers grew 10% from the same period in 2020 to more than 1.7 million.

Along with the highlights I previously mentioned, we also saw solid improvements across the board in other key metrics for the quarter, including another [ph] steep (00:04:12) decline in net subscriber acquisition costs per subscriber and the lowest LTM attrition rate in the past nine quarters. I believe that these strong results speak to the fact that our core value proposition, proven over two decades of reliably taking care of our customers and their families, is as relevant today as ever. Dale will provide more specifics on the financials during his remarks as well as share our thoughts about our full year 2021 guidance.

If the past year has taught us anything, it's that there is no better time for homeowners to have a comprehensive smart home system. The 1.1 billion daily events processed by our smart home operating system across more than 23 million connected devices are the best indicator of the frequent engagement of Vivint's customer base. We are uniquely qualified to help our customers deal with any environment across the various smart home devices we support: from door locks, cameras, security monitoring, thermostats, lighting controls, garage door controls, and many other connected devices.

All of these innovative products are designed to work together seamlessly through our elegant platform that homeowners can control from their in-home touchscreen hub through a single app on their phone, or by simply using their voice.

Vivint services also include life-saving and life-protecting 24/7 professional monitoring for emergencies such as medical, fire, carbon monoxide and burglary alerts. Our vertically integrated model includes dedicated customer care and monitoring teams to ensure that we respond to alerts within seconds. Our cloud platform and proprietary technology also allows customers to seamlessly manage and protect their homes, regardless of whether they're socially distancing inside the home or from somewhere outside of it.

Vivint takes care of our customers and their families while providing the peace of mind that people demand during times of heightened awareness, anxiety, uncertainty and mobility. We've been securing and innovating smart homes for over 20 years. In our experience since the onset of the pandemic has only cemented in our minds the fact that our customers will continue to value home security and smart home technology during challenging economic and societal times, underscoring the strength and resiliency of the Vivint model in any type of environment.

With attention now turning to the reopening of the economy and having this coincide with the onset of our summer selling season, we remain bullish about the near-term demand for the business. Given that approximately 50% of the adult population in the US have now received at least one dose of the vaccine and that by the end of the month we anticipate that all states will have lifted mandatory quarantine restrictions, the tried and true process of selling door to door and installing new Vivint systems inside of homes is getting back to normal.

We believe the pent-up demand for travel also plays right into our hands. To the extent last year's shelterers became this year's travelers, they still have every reason to remain highly engaged with their smart home systems. Based on interaction volumes with our platform before COVID, during COVID, and now as the country begins to look beyond COVID, our systems and services have proven to be just as relevant in all of these environments.

We're still respectful of the fact that we continue to operate in a world actively dealing with COVID-19. We've increased the preparedness of our direct sales team as they head out to markets across the US at full capacity, and they'll be ready to go with all the right training and necessary PPE to interact with current and new customers.

As a reminder, last year at this time, we had to swiftly move our call centers and corporate employees to a work-from-home environment, paused our entire direct-to-home sales teams for about six weeks during the first wave of the pandemic, delaying the start of the summer selling season. At this point, we fully expect to return to a more normal summer sales season this year.

Meanwhile, our other sales channel, National Inside Sales, which onboards nearly half of all new subscribers in a normal environment, has turned in robust results through the pandemic and we believe that momentum will continue in 2021.

We have long believed the total addressable market for smart home presents a massive opportunity. And in the not-so-distant future, the vast majority of the 150 million homes in North America will be running on a comprehensive smart home operating system. We believe Vivint is the premier end-to-end smart home platform company with the most robust service offering and as such is the best positioned provider to take advantage of this opportunity.

We believe in order to take advantage of the growth opportunities in smart home, it's important that we increase our focus and investment in our brand, technology and new product development. On this front, I'm pleased with the early returns we've seen from our brand investment rolled out during the fourth quarter of 2020 to drive better consumer awareness on a national scale.

Those investments will continue as we tell the story of who we are, what we do and how we can add value to people by delivering the security and peace of mind they desire. But beyond the brand, we also think now is the time to step things up in terms of technology and our product vision to maintain our position on the leading edge, new product development and to continue pushing new boundaries by delivering a transformative smart home experience to every home.

Before I turn the call over to Dale to go through specifics of our first quarter results, as you may have seen, Vivint recently resolved the matter with the US Federal Trade Commission related to certain historical instances of violations of the company's policies by sales employees. We are pleased to put this matter behind us. Vivint takes matters of compliance seriously, particularly as customers across the country put their trust in us to protect their homes and families.

We had already taken steps before the FTC began its review to strengthen our compliance policies and we will continue to make this a focus going forward. To that end, we are deeply committed to operating with integrity, doing right by our customers, delivering on our commitments to stakeholders and providing exceptional service to our customers.

I will now turn the call over to Dale.

Dale R. Gerard

Chief Financial Officer, Vivint Smart Home, Inc.

Thanks, Todd. Before I get into the results for the quarter, just a quick comment on the recent statement by the SEC related to the accounting for warrants issued by SPAC companies. Following the issuance of the statement, we reevaluated our historical accounting for both the public and private placement warrants assumed in conjunction with our merger with Mosaic in January 2020. Like a majority of SPACs, we previously recorded these warrants as equity.

However, based on our valuation, we determined that the warrants should have been classified as liabilities and measured at fair value on the closing date of the merger with subsequent changes in fair value reported as non-operating income or expense in our consolidated statements of operations each reporting period. On Tuesday of this week, we filed an amendment to our 2020 Form 10-K to restate our previously filed financial statements. As a result of this restatement, we recorded a $109.3 million non-operating loss related to the warrants and our warrant liability was $83.6 million as of December 31, 2020.

I'll now walk through the financial portion of the presentation that we posted today in conjunction with the earnings release. Looking on slide 6, we highlight a few metrics for the subscriber portfolio, which continue to be strong across the board. Total subscribers grew 10.2% from 1.55 million to 1.71 million. Average monthly revenue per user or AMRU increased to $67.24, up 3% year-over-year. The increase in AMRU was driven by additional sales of new products, such as our latest generation of outdoor and doorbell cameras, as well as the recognition of deferred revenue.

On slide 7, we cover revenue and adjusted EBITDA for the quarter. For the first quarter of 2021, revenue grew by 13.2% to $343.3 million. The revenue growth is attributable to previously mentioned double-digit increase in total subscribers as well as the increase in the average monthly revenue per user. Adjusted EBITDA grew nicely in the first quarter. The primary drivers were the scaling of service and expense subscriber acquisition costs. For the quarter, we increased our adjusted EBITDA margin by 270 basis points to 47.2% of revenue compared to 44.5% in the first quarter of 2020.

Moving to slide 8, we will highlight a few points on the subscribers originated in the first quarter of 2021. New subscriber originations led by a 29% year-over-year growth in our National Inside Sales channel were 60,127 for the quarter. How and which subscribers we onboard is important to our success today and in the future, and we continue to redefine and boost the underwriting requirements and process to qualify and onboard new subscribers.

One of the positives of the enhanced underwriting requirements is that we are able to reduce the number of retail installment contracts or RICs that are financed on the company's balance sheet. For the first quarter of 2021, we saw a 77% reduction in the number of subscribers financed through retail installment contracts. By shifting a greater proportion of our subscribers away from RICs and towards third-party financing partners and pay-in-full arrangements, we're able to reduce our net subscriber acquisition costs and improve the company's cash flow dynamics.

Speaking of our third-party financing partners, I'm pleased to announce we've recently completed a successful renegotiation of our agreement with Citizens Bank, our primary financing partner under the Vivint Flex Pay program. This renewal resulted in a contract extension of three years and the implementation of a new line of credit finance offering to our consumers, which will streamline the initial sales process and facilitate up-sales and upgrades of additional and new equipment during a customer's lifecycle.

Moving to the new line of credit, finance offering changes the timing of when the merchant discount rate and loss share fees are incurred, which will impact the amount of cash in the near term. That said, we are fully committed and intend to operate the business on a cash flow positive basis this year and going forward.

Moving to slide 9, we will cover service costs per subscriber and new subscriber acquisition costs per subscriber. We continued our trend of year-over-year improvements in net service cost per subscriber moving from $11.76 in the first quarter of 2020 to $10.77 in the first quarter of 2021. This reiterates the advantage of Vivint's vertically integrated smart home cloud platform, which encompasses the software, the hardware, the installation and ongoing customer support. As we continue to make improvements in all these areas, we're seeing positive trends in both the cost of service as well as customer satisfaction.

Our net service margin continued to be in the high 70% range at 77.7% for the first quarter of 2021. A drop in service cost per subscriber is driving a significant portion of the increase in adjusted EBITDA dollars as well as adjusted EBITDA margin percentage.

On the right hand of slide 9, we highlight net subscriber acquisition costs for the last 12-month period. For the period ended March 31, 2021, net subscriber acquisition costs per new subscriber decreased to $66. That's 93% lower year-over-year as we continue to drive down the number of new subscribers that are financed via RICs and shift to a higher mix of customers utilizing our financing partners or paying in full the purchase of their smart home products.

During the quarter, we also continue to benefit from pricing leverage on the point-of-sale purchase and installation of equipment. Slide 10 depicts our typical subscriber walk that illustrates the changes in total subscribers at quarter-end. One of the pleasant surprises throughout the pandemic has been the performance of our subscriber portfolio. Once again, our attrition improved ending at 11.8%, which is 230 basis points lower year-over-year and at a nine quarter low.

Our portfolio continues to perform better than expected in terms of both, attrition and other leading indicators. In terms of cash flow, we saw a nearly $19 million improvement in net cash used in operating activities during the quarter. We finished the first quarter with $274 million of cash on hand and a very strong liquidity position of approximately $600 million.

Finally, moving to our guidance for the year on slide 11, the top of the page highlights several fundamental characteristics of our financial model, including reoccurring monthly revenue from long-term subscriptions, a highly predictable business model and the ability to thrive in all economic environments. We are pleased with the momentum in the business from the strong start to the year and we're bullish about our ability to operate the direct-to-home sales team during this summer selling season at full capacity.

We are also aware of potential supply chain disruptions, inflationary pressures and hiring constraints that could limit further upside. Taking all of these factors into consideration, we are confirming our original guidance as follows. We still expect to end 2021 with 1.8 million to 1.85 million total subscribers. Our estimate for 2021 revenue continues to be $1.38 billion to $1.42 billion. And finally, we affirm our previous 2021 adjusted EBITDA guidance of between $640 million and $655 million.

This concludes our prepared remarks on the first quarter. Operator, please open the call for Q&A.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Your first question comes from the line of Paul Coster from JPMorgan. Your line is now open.

Paul Coster
Analyst, JPMorgan Securities LLC

Q

Yeah. Thanks very much for taking my question. So, it sounds like the guidance implies that supply chain risks [ph] present (00:20:22) upside perhaps, but factored into the guidance, so limited from a downside, I think you're one of the first to sort of tilt it in that kind of way. Can you just talk to us about what your biggest sort of component risks are and how it is that you seem to be managing through this problem so well on a relative basis?

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

Hey, Paul. This is Dale. Thanks for joining the call. We look at it – a big part of our growth initiatives and some of the stuff we're trying to do is really around camera attach rates. And as you know, we think that's one of the big selling points and why people really like smart home is one of the big advantages we think our systems have over others, because they're integrated, [ph] very (00:21:15) analytics and the different things that we can do with that in terms of notices and so forth with customers.

And so, part of what we're doing with our pricing and how we're selling and what we're seeing in terms of take rate or adoption of additional cameras, we are in good shape we believe right now. But if adoption rates are higher than we think and if there is any disruption in terms of chip manufacturing and/or – the big thing really – one of the big things is logistics, frankly, the ports and getting them in from the ports, it could be some where we may have to limit the number of cameras we sell in the second – maybe late in the third quarter or fourth quarter.

But we think we've addressed that. We're doing some stuff with airfreight and shipping. And so, we're just calling that out, as we say, hey, based upon – we're off to a good start, we think that the year – we're going to have a good year. But with some stuff around supply chain, like there's some inflationary pressures out there, there's some hiring constraints, we're probably no different than other companies as we try to continue to ramp up, especially in the field and hire in the markets that we service, to be able to hire enough installers and service professionals, to be able to take care of the customers the way we want to take care of them.

So, we just kind of put all that stuff together and said, hey, based upon where we are today and what we see, we think confirming our guidance, which we think is really good guidance for the year to begin with, is the best path at this point.

Todd, I don't know if you just want to [ph] add anything (00:22:9).

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Yeah. No, I was just saying, Paul, you kind of [ph] comp (00:22:51) that which is based on supply chain and the issues that Dale mentioned, the potential for upside beyond where we sit is limited to product being delivered to the US and being able to install that. So, it's not impossible that we could see some upside, but it's going to be quite difficult; or just like everyone else, there are supply chain issues out there, chips being kind of front and center driving most of that. But we do feel very comfortable with this number. We're fortunate that we have a seasonal business in some regards because we preorder a lot of the hardware and had done that last year. And so, a lot of what we need to attain these numbers we already know we have kind of in [ph] site (00:23:42).

Paul Coster
Analyst, JPMorgan Securities LLC

Q

Got you. And a quick follow up, I think investors have been working really hard to try and figure out what's going wrong, because the stock's been going down and we're all sort of very anxious, but [ph] it's nothing (00:23:55) obvious here. Let me just sort of try my luck, it sounds like you've entered into an extended term with Citizens Bank. But as part of that term there's different allocation of the credit risk, does that relate back to this FTC issue? And then passing, Todd, can you just tell us what is actually the FTC issue identified and when it occurred?

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

Yeah. I'll take the first part, Paul.

Paul Coster
Analyst, JPMorgan Securities LLC

Q

Yeah.

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

It's Dale, and then Todd will address [ph] the issue (00:24:27). In terms of the extension with Citizens, we're very, very pleased with our partnership with Citizens. They've been a very good partner. We've had a relationship, doing consumer financing with them, since early 2017. And so, we were glad to be able to extend it. The changes that we're making in that program with Citizens really has nothing in terms of the FTC. It was really part of the negotiation to move from the installment line and to, what we call, a line of credit, which really is better for us long term and better for our customers. It's easier for the onboarding process. And then, really where we'll see the benefit is the additional sales of hardware, either additional products that customers want to take or as we roll out new products and customers want to add those to the systems, the line of credit allows for that in a way that the installment loan, which was a kind of a fixed loan, didn't.

And so, in reality, the way the terms are set with the line of credit are more standard terms. Our terms that we have with installment loan were probably not what was standard in the industry. We were able to do that, I think, early on. So by moving to the line of credit, one of the things that was part of that was we'd kind of go to more standard terms around how the users of these products pay for that – the credit offering from Citizens or from other banks, [ph] as a matter of fact, for this (00:25:59).

And then, Todd will take the second [ph] for that (00:26:01).

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Yeah. I mean, the first thing I'd say is we're glad to have this FTC settlement done. You now know why we have not – we've been asked about refinancing, paying down debt, and we were not able to do that, didn't feel like it was good timing in the middle of that FTC settlement happening. So, we're glad to have that past us and in the past.

Secondly, we're a company that we want to provide great service, take care of consumers, our customers. And so, this behavior that's not consistent with integrity and doing right by consumers has no part of this company. But back in 2017, we did have some salespeople that got around some systems that we found out and let those people go, and that was part of this investigation by the FTC.

And the thing is, when we found out, we did let those – we termed those people, let them go. But again, that's in the past and done. We're glad to have that behind us. We've definitely made – and we do this every year – enhance improvements on compliance and systems and controls to ensure that underwriting and everything is up to par and again compliant with laws of the United States from a financing perspective. So, again, glad to have that behind us and done and settlement over.

Paul Coster
Analyst, JPMorgan Securities LLC

Q

All right. Thanks so much, Todd and Dale, thanks.

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Hey. Thank you, Paul.

Operator: Thank you. Your next question comes from the line of Jeff Kessler from Imperial Capital. Your line is now open.

Jeffrey Ted Kessler
Analyst, Imperial Capital LLC

Q

Thank you. And it's been great working with all you guys, as I will – hopefully we'll continue to talk, just not in the position I am, that's all. I've got a couple of questions here. Firstly, what are the – it looks as though this year, from the sound of it, look, you're going to have to – now that the economy looks like it's opening up, you are making investments you're talking about and you've already started with in branding the company.

Now, can you talk about what other types of investments and how much that may cost you that you are going to be involved with assuming that the overall economy opens up, it's probably timely for you to start pushing on some of the other home – some improving home automation, trying to put some distance between you and others in terms of technology, trying to do things in terms of maybe improving. I don't know, [ph] whether (00:29:03) improving your training or focus on how you onboard your new salespeople, spending more money there. Can you just talk about the various types of increased investment you'll be doing in addition to branding?

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

And by the way, it's been great to work with you through these years. We're going to miss this, I guess, [ph] professionally (00:29:31), but hopefully, relationship continues.

Jeffrey Ted Kessler
Analyst, Imperial Capital LLC

Q

Yeah. I'm sure it will with my other guys here.

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

That sounds great. Well, so a couple of things. We agree that investments in continued product enhancement and quality and technologies is critical so that we can keep our lead in the market and deliver the best services that we can to consumers. I mean, that's first and foremost. The quality has got to be there, the value's got to be there or we'll continue to drive that. We are investing in new tools and technologies from onboarding customers, underwriting customers. We've built these tools over the years. Some of them, we feel, need to be refreshed.

You'll probably end up seeing within a year or so a platform, kind of reinvestment in the platform. Again, we built out our operating system seven, eight years ago and we believe that there is some updates that can be done and will be done to enhance that experience for the consumer, allow us to do more upgrades, have more content for consumers, information to consumers that allow us to kind of deliver service to them through those – through the enhanced operating system. So, that's going to happen. Now, we are super pleased with the results and it's been – it's early. I mean, we started doing branding and marketing really in Q4. But as you saw with our Q1 numbers, 13% top-line revenue growth compared to [indiscernible] (00:31:13), we're starting to see some momentum there.

Now, we already mentioned earlier that with some supply chain constraints we're not going to be off to the races because we have to be – if we do add customers, we need product and hardware to be able to install. So although we're [ph] having a great year coming out (00:31:37), we think the numbers and projections we have are strong. The cash flow dynamics of the business, the attrition numbers, our net operating margins, our net SAC are all super strong and improving year-over-year. So, we're really excited about how the company is positioned and what the future looks like for us.

Jeffrey Ted Kessler
Analyst, Imperial Capital LLC

Q

Okay. Does this include an increased investment in SAC?

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

Can you maybe explain what do you mean by that?

Jeffrey Ted Kessler
Analyst, Imperial Capital LLC

Q

Well, you talked about new tools for onboarding customers and getting customers trained and things like that.

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

Yeah. I mean, it's really within our information technology, sorry about that, area which we do allocate out SAC, some of that's SAC, some of that's service. So, yeah, there'll be some of that there. And then some of the brand spend that's directly contributed to the media that we're doing is actually being [ph] hit out to SAC (00:32:45) also. But it's part of like – as we said early when we did the fourth quarter call and talked about kind of what we expect 2021, we said, hey, we're going to make investments in really three areas that Todd just talked about. You're going to see those – really, you'll start seeing the impact of those [ph] problems (00:33:04) in Q2 in terms of where we're kind of really starting to get some of the spend in terms of brand as we kind of rolled out the summer sales force. And then, as we've hired up for some of the stuff we need to do in technology and product development, you'll start seeing that kind of come through Q2, Q3.

Jeffrey Ted Kessler
Analyst, Imperial Capital LLC

Q

Okay. Second question actually is on attrition and going through the various components of attrition, obviously, percentage of customers coming to term on their contracts is obviously an important one. Movers is an important one. People who can't pay is an important one. People who don't like your system or whatever is somewhat important. These all move around depending on the times we are living in and the ability of your firm to create a better value proposition for your customers. What – [ph] I see (00:34:04), but what is going on with attrition, because clearly you've been saying that your sweet spot is probably going to be somewhere in the 12% or maybe the high 11% to 12% to 13% area for some time to come. In the past, you seemed to have maybe underestimated how far attrition can go up. But now, you seem to be underestimating how far attrition can come down.

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Yeah. Well, so here's a couple of things. We deem that we are fully integrated platform end-to-end solution. We continue to make improvements in the hardware, the installation process, the firmware. We've got this incredible feedback loop that we've talked about. So, we continue to make improvements and enhancements from that perspective. But if these products work, and we have 14 or 15 devices on average per home, if they work consistently and the use cases are relevant to consumers, they keep the product. Now, there are obviously circumstances where people lose their jobs or have financial changes in their lives that cause some of these people to cancel. We hope to think people – it's not because people don't like our systems, but maybe that happens occasionally.

But the other is if you've noticed in the last year, we've made great enhancements to the underwriting. The reduction in RICs to the platform is going to have continued impact on attrition over time. And again, enhancements in every little detail of what we do to deliver service to consumers is going to impact that [ph] much (00:35:46). So, we're hopeful. We're not trying to be pessimistic. We continue to see potential gains on that side. This is a pretty – for a consumer-facing business, kind of 1% monthly attrition is pretty incredible. And then, you add to that our net subscriber costs come down substantially and our net service cost of $10.77, this is a really good story and real good build up from what we've been trying to accomplish over the last couple of years.

Jeffrey Ted Kessler
Analyst, Imperial Capital LLC

Q

So, is the sweet spot – are you changing at all your view of what may be your long-term sweet spot range should be for LTM attrition?

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

No, Jeff. At this point Jeff, no. I think what – like Todd said, I think as we get more time in here and we continue to see how attrition performs, we may [ph] pick it up (00:36:44), but at this point, I think we're going to stay, where – [ph] as I said, where we (00:36:48) guided.

Jeffrey Ted Kessler
Analyst, Imperial Capital LLC

Q

All right. Great.

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

The one thing I would say that we're super pleased with is – well, all of it, all results are great. But the $10.77 per subscriber in net servicing cost that means people are – our systems are working. We're not having to [ph] roll trucks (00:37:06) to fix things as often as we used to or replace hardware. So, again, the better and more reliable the system is and the more elegant – in fact, the more robust the system is, the more we see attrition coming down over time. So, we're not done from an aspiration perspective, but we think we're feeling confident about what we've projected to the market for the year and hope to make gains over that, if possible.

Jeffrey Ted Kessler
Analyst, Imperial Capital LLC

Q

All right. Great. Thank you very much. I appreciate it.

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

Thanks again, Jeff. Good luck in retirement.

Jeffrey Ted Kessler
Analyst, Imperial Capital LLC

Q

Thank you.

Operator: Thank you. Your next question comes from the line of Rod Hall from Goldman Sachs. Your line is now open.

RK Raghunathan Kamesh
Analyst, Goldman Sachs & Co. LLC

Q

Hi. This is RK on behalf of Rod. Nice job on the results. Could you expand on the difference between the installment lines versus line of credit and how it's better for customers? And you also mentioned some impacts to cash flow. So, could you give us some color on that?

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Yeah. Hey, RK. So, the line of credit – I mean, what we have with Citizens and what we've been putting on Citizens is kind of a fixed-term installment loan. And so, what that means is once the customer finance what they finance at the initial point of the sale, that was fixed. And if the customer called back six months later and said, hey, I only bought two cameras, I wish I [ph] would have (00:38:32) bought a third camera, so I could put it around on my back porch, we weren't able to actually add that to the finance. And in the line of credit, it's more like a credit cards the way to think about it. And so, that will allow us to actually go back and add to that system, and they could – instead of have to come out of pocket at that point for that camera and the install, they can add that to the line of credit. So, that's really the big difference. It just allows us that – the customer and allows us, as the company, to be able to offer that product to them, and the customer then to be able to finance that going forward as they want new or additional products installed in their homes.

In terms of the cash, the way the installment loan product has worked, we paid the kind of the MDR fee and the loss share over time. So, every month, if there were – the MDR fee was paid every month and losses were paid as occurred up into the loss based upon the last loss arrangements that we had, the caps that we had in place. The way it will move, the line of credit will move eventually as we transition through the next kind of 24 months, it will move to – that'll be like a more standard where we'll pay the MDR fee and then the expected losses upfront. And so, it'll be a net settlement. Very similar to how our program works with Fortiva, our other financing partner.

RK Raghunathan Kamesh
Analyst, Goldman Sachs & Co. LLC

Q

Super helpful. I also wanted to ask about direct-to-home. So, the subscriber growth sequentially is a bit weaker than historical trends. And I understand they're still operating in a COVID environment. But could you talk about why that is and expand on the environment there?

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Yeah. Look, we're basically saying that we believe that we'll operate in a normal way from deployment perspective. We've deployed the majority of our direct-to-home salespeople across the country. There's still some number of them that are still going out to market. We are obviously respectful of this social distancing still at this point, even though that is changing somewhat with the vaccinations and the percentage of people who have been vaccinated across the country and based on CDC guidelines and suggestions. But it feels like it will be back to more of a normal type year for the summer selling season, which we are excited about.

Now, we've made adjustments that based on COVID, it may be accelerated some of the adjustments on how we underwrite and do approvals for consumers [ph] and their spend (00:41:17). We used to do it on our devices. We have salespeople who travel around with an iPad. Now, it's done on the consumer's device, so we can maintain the social distancing even in the future.

The second thing that it really does for us is, from a compliance perspective, it really tightens things up. So, this is a net positive all the way around. We're again trying to be respectful of COVID-19 and making sure that we're not spreading anything, that we are still checking people's health on a daily basis in market, wearing the appropriate masks and gloves and that sort of thing. But then, from an underwriting and compliance perspective, with the adjustments, it's going to be a net positive for the company.

RK Raghunathan Kamesh
Analyst, Goldman Sachs & Co. LLC

Q

Thanks, Todd. And last question from me. Could you give us an update on the insurance business?

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Yeah. So, we're still – I would say, we're still in test mode. We believe we have great upside potentially with that business. And again, this is the great thing about owning our platform and the data that we have. If you think about it, it's hyper local data inside of the home, based on consumer actions and interactions with the system, so usage patterns, we have all of that collected inside of our data that we collect on a daily basis. We're not quite ready to start announcing volume or future projections, but we're trying to make sure that we have everything from a compliance perspective to a financial perspective and underwriting perspective dialed in before we really expand that business out.

RK Raghunathan Kamesh
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks, guys.

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Thanks, RK.

Operator: Thank you. [Operator Instructions] And your next question comes from the line of Erik Woodring from Morgan Stanley. Your line is now open.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Hey. Good afternoon, guys. Congrats on the quarter. And again, congrats on the attrition rate, really impressive stuff. I guess I wanted to ask an earlier question perhaps a different way and that was, would you say that through the end of the March quarter, there was still a bit of, what I'd call, COVID complacency driving that metric? Meaning, I know you had less than 10% of your base reach the end of term in 1Q, but are people perhaps putting a decision to reevaluate their smart home provider on hold for now given the environment? Just curious, your take on that, and then I have a follow-up. Thanks.

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Yeah. I mean, look, that could be true with some of the consumers. And then, the other side of that we have better underwriting. Our systems are working and operating better as we continue to make improvements, like I mentioned earlier, on firmware, software, new hardware releases, installation protocols, just every little thing that we do. And we've been through different types of downturns and issues in the past, then this kind of is proving out again the fact that what we deliver to people, which is peace of mind, in different ways for different people, based on their situation and their living environment, that this is something that people see value in. And we continue to try to push those boundaries and make sure that we're more and more relevant from a consumer perspective every day.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Okay. That's super helpful.

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.
A

Yeah.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC
Q

And then, I guess, my second question, selling expenses were up more than 100% year-over-year. Smart home subscribers were up 20%. What drove that growth in the selling expenses? Should we interpret that as meaning it's getting more expensive to acquire new customers? And then, how do I kind of tie that with net SAC that, obviously, continues to reach very impressive new lows? Thanks.

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.
A

Yeah. So, a couple of things. Last year, in the first quarter, if you recall, we shut down kind of direct-to-home, so a part of your year-over-year is the fact that over the last – I don't know, the last two or three weeks of the first quarter, there was no spend. When I say no spend, we kind of said don't spend any more money on recruiting, training, anything. So, that's a big variance or a variance kind of year-over-year in terms of that. And then, you have some of that brand spend also. As I said, we're pushing some of the brand spend that's media, directly tied to commercials and so forth, into SAC also.

So, I mean, in terms of terms of our gross cost of SAC, it's in line with where we have been. And again, we keep driving down the net because we're charging more for – sorry, we're selling more products, so the upfront, basically, the number of cameras, number of devices we're selling is higher.

And I think the other thing – just the other thing [ph] I'd call out (00:46:42), because I actually look at selling expense or SAC excluding stock-based comp. So, stock-based comp is a big driver in that in terms of the legacy equity that we had that came through in the first quarter that also got expensed, plus the new grants that are there. So, you have kind of a double kind of whammy there in terms of that expense. But if you looked at – I think it's up 11%, I think, without that stock-based comp charge, you're only up about 11%, around $5 million year-over-year.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC
Q

Okay. That's really helpful. And then, I guess, if I can squeeze in a last one. I remember you guys kind of previously guiding to long-term adjusted EBITDA margins in the mid 40%. Correct me if I'm wrong. But is that still how we should think about the long term? And I say that compared to, obviously, your current guidance which would imply you're kind of already there? And that's it for me. Thanks again and congrats again.

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.
A

Yeah. I think, again, a lot of things, we're seeing improvement across the board. Right? We're seeing better servicing costs, and as we can continue to drive down service costs, while still providing really exceptional service for our customers. Again, being able to leverage G&A in terms of what we're spending there, I think overall we still think kind of in the mid-40s, whether that's 45% to 47% is really kind of where we see margins at. For the near term, I think as we continue to invest in the business and make decisions that we think will help the business long term be more successful in terms of products, technology, brand, as Todd has mentioned. And so, that's kind of where we're shooting for today.

Erik W. Woodring
Analyst, Morgan Stanley & Co. LLC

Q

Okay. Thanks, guys.

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

Hey, thank you.

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

A

Thanks, Erik.

Operator: Thank you. Your next question comes from Marlane Pereiro from Bank of America. Your line is now open.

Marlane Pereiro
Analyst, BofA Securities, Inc.

Q

Great. Thank you for taking my questions. I just have two very quick ones. One, can you share any thoughts on addressing the capital structure? And two – and I apologize if I missed this, but for attrition, how do you think about a normalized level or kind of a steady state for the business? Thank you.

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

Sure. I'll take [ph] it a little (00:49:11) backwards. Attrition, I think we've kind of said we think 12% to 13%. If I had to group attrition, I'd say attrition is somewhere in the high 11s to probably low 13s. So, maybe it's 12% to 12.5% is kind of where we think at this point. Again, as Todd said, as we continue to provide better service, better value to our customer that they really – they look at this and say, hey, I need this every day as part of my life. I mean, our interactions that we saw pre-COVID, during COVID and post-COVID continue to increase in terms of how many times people are interacting with their system via their app.

And so, that tells us that – and I think one of the things that we actually found during COVID is that those interactions went up. And I think part of that's being able to answer the door and get your deliveries without – touchless deliveries, not having to talk to the person, but you talk to them through your video camera, your doorbell camera, those type of things. So even when people go back to the office, which I think people will at some point, they've got these uses now, these use cases that they've discovered while they were at home that actually will be beneficial. And so, we kind of – again, attrition we're happy where it is.

And the thing, I think, that's important about attrition also is, as somebody mentioned earlier, where less than 10% of our portfolio is at the end of their initial term. As that goes up, that has a – that has an impact that will lift attrition automatically, even though attrition is not really performing worse. It's just as you – the percent of customers at the end of term, you always see a little bit of a higher percentage of attrition related to those customers. If we can drive that down, then we can lower that long-term attrition number.

In terms of the cap structure, I think Todd said, we'll be looking to address that, I think, sooner than later as we want to go ahead and take care of – I think we've got some 2022s, 2023s, for sure, that we'd like to take care of the maturities and extend those. And so, I think you'll see us look to be out in the market at some point in the near future.

Marlane Pereiro
Analyst, BofA Securities, Inc.

Q

Great. Thank you, Dale.

Dale R. Gerard
Chief Financial Officer, Vivint Smart Home, Inc.

A

Thank you. Have a good day.

Operator: Thank you. There are no further question at this time. I'd now like to hand it over to Mr. Todd Pedersen for any closing remarks.

Todd R. Pedersen
Founder, Chief Executive Officer & Director, Vivint Smart Home, Inc.

We appreciate everyone getting on the call with us today. And again, we're looking back at this past quarter, which was a buildup from the past couple of years, a plan set in place. We're excited to see the acceleration in top-line revenue growth, improvement in LTM attrition, net subscriber acquisition costs, servicing costs. Everything with the business is performing incredibly well. We're excited about the future of the business and look forward to getting on the phone call with you guys again in the next quarter. Thank you.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.