SONOS

Q3 2019

August 7, 2019

Fellow shareholders,

We are pleased to report our fourth consecutive quarter of record revenue growth. During the third quarter:

- We generated record Q3 revenue of $260 million, representing 25% growth year-over-year and 28% growth on a constant currency basis.
- We delivered adjusted EBITDA of $7 million, compared to a $2 million loss last year.
- We realized a net loss of $14 million, compared to a loss of $27 million last year.

We demonstrated strength across our product portfolio in Q3, with revenue growing 11%, 34% and 14% year-over-year in wireless speaker, home theater and component categories, respectively. Our voice-enabled products, Sonos One and Beam, continued to perform particularly well, and Sonos One revenue increased by 61% year-over-year.

Revenue from the sell-in of our technology modules to IKEA primarily drove 221% growth in our "other" category. Our regional performance was balanced; Americas increased revenue by 18.4% and EMEA increased revenue by 16.6% year-over-year. APAC increased revenue by 168.1% primarily due to the recognition of IKEA related revenue in that region.

In Q3, we combined strong revenue growth with continued focus on enhancing our profitability. Our operations team has made considerable progress in more efficiently bringing our products to market. The team's efforts contributed to realizing a 45.1% gross margin in Q3, helping us track above our annual guidance range of 40-41%. In addition, we were able to deliver improved adjusted EBITDA and net income metrics on a year-over-year basis while increasing investment in R&D by 25.1% year-over-year. Our continued investment in R&D is critical to advancing our competitive differentiation and successfully executing on our long-term product roadmap.

This quarter, I would like to highlight our collaboration with IKEA. Accelerating new product velocity has been one of my primary focus areas since becoming CEO. Equally important, is thinking more expansively about new addressable markets and how we monetize our technology. Our collaboration with IKEA is the perfect example of our efforts in action.

One of the many reasons this partnership makes so much sense for customers is that IKEA and Sonos both believe sound enhances life at home and should be considered a fundamental part of home design. Together, we believe technology should complement and enhance the way people live, rather than interrupting it. The new product line, named SYMFONISK, combines Sonos' sound experience platform with IKEA's home furnishing knowledge and design philosophy. The first two products in the range are a table lamp speaker and a book-shelf speaker. The table lamp speaker (U.S. MSRP $179) combines light and sound into one product, helping de-clutter the home with fewer devices and cords. The book-shelf speaker (U.S. MSRP $99) gives customers a great sounding, versatile speaker at an affordable price. Both products fully integrate with existing Sonos systems, offer Trueplay tuning and are controlled by the Sonos app, providing customers easy access to a breadth of streaming music, podcasts and audiobook content.

The IKEA partnership represents an innovative way to bring the Sonos experience to new potential customers at a global scale. IKEA offers a differentiated footprint as a distribution partner, providing retail showroom environments that present potential customers with a natural, home-like demo experience. IKEA has unparalleled reach, having welcomed almost 1 billion people to their 422 stores in over 50 countries last year. The SYMFONISK products began selling in approximately 300 IKEA stores last week.

Partnering with IKEA enables us to monetize our technology by enabling the Sonos experience in products manufactured and sold by IKEA. The collaboration also brings the Sonos sound experience to unique form factors at new price points. The $99 price point is particularly interesting, as we believe it has the potential to significantly expand our audience by bringing the Sonos experience into millions of new homes that our current portfolio does not address. Once introduced to the simplicity of the Sonos experience, we anticipate that many customers will consider adding additional Sonos products to their homes to augment their home sound systems.

FY 2019 outlook

We expect to deliver FY2019 revenue in the range of $1.250 to $1.260 billion (vs. our original range of $1.250 - $1.275 billion). Our refined range implies a Q4 revenue range of approximately $283 to $293 million. It's important to note that foreign exchange exposure has negatively impacted our revenue by $20 million through the first three quarters of FY2019.

We expect to exceed the high end of our annual gross margin guidance of 40-41% by approximately 100 basis points. This improved gross margin performance supports increasing our adjusted EBITDA range to $86 to $88 million (vs. our original range of $83 to $88 million). Our refined range implies a Q4 adjusted EBITDA range of approximately -$5 to -$3 million. We expect to deliver at the high end of our original range despite increased Q4 spending associated with a new product launch and increased R&D investments to pursue new initiatives.

Q3 was yet another proof point in our ability to execute against our long-term goals. We delivered strong revenue growth and improved our margins while continuing to invest in the future. In Q4, we look forward to consumers experiencing the two new innovative products that we have developed with IKEA and to sharing something new we know customers will love.

Patrick Spence
CEO

P.S. Our playlist this quarter is inspired by our collaboration with IKEA and features some of our favorite Swedish artists.

Now Playing at Sonos:

SONOS

Financial summary

Q3 FY2019 results (three months ended June 29, 2019)

Revenue

In Q3 FY2019, we sold 1,083,216 products, representing 22% unit growth period-over-period, and generated $260 million in revenue. This unit growth translated into a 25% increase in revenue compared to Q3 FY2018 and 28% on a constant currency basis.[1] In Q3 FY2019, the largest drivers impacting our period-over-period revenue growth were Sonos One and Beam. Sonos One, which was launched in Q1 FY2018, grew revenue 61% year-over-year. This performance re-accelerated wireless speaker growth, driving 17% unit growth and 11% revenue growth in the quarter. Beam's continued strength contributed to a 64% increase in home theater speakers products sold and a 34% increase in home theater speakers revenue. The recent introduction of Sonos Amp in Q2 FY2019 drove 3% unit growth and 14% revenue growth year-over-year in the components category.

Revenue in the "other" category grew 221% year-over-year as we ramped production of the modules related to our collaboration with IKEA. We recognize revenue when modules are received by IKEA's manufacturing partner for final assembly of SYMFONISK products. These products became commercially available at select IKEA stores in early August.

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
(In thousands)				
Wireless speakers	$ 104,626	$ 93,867	$ 401,994	$ 453,185
Home theater speakers	89,660	66,732	388,902	283,952
Components	48,135	42,283	137,539	113,530
Other	17,698	5,516	38,228	13,402
Total revenue	**$ 260,119**	**$ 208,398**	**$ 966,663**	**$ 864,069**

Gross margin

We delivered Q3 FY2019 gross margin of 45.1%. Despite a significant mix shift to newer, high growth products such as Sonos One and Beam, gross margin was only 70 basis points lower on a year-over-year basis due to a reduction in licensing revenue and unfavorable foreign currency exchange impacts. From a sequential perspective, Q3 FY2019 gross margin was 210 basis points higher than that of Q2 FY2019 due to favorable volume and reduction in costs. This quarter's results illustrate the effort and focus of our product and operations teams as they seek to streamline our supply chain and re-engineer products to improve performance while reducing costs.

Operating expenses

Our operating expenses in Q3 FY2019 were $132.4 million, representing 50.9% of revenue for the period. On a comparative basis, operating expenses increased $15.3 million, or 13.1%, compared to Q3 FY2018. Higher operating expenses were primarily driven by increases in research and development and general and administrative spending. Research and development investments increased $8.9 million, or 25.1%, compared to Q3 FY2018, related to increased hiring and personnel expenses. General and administrative expenses increased by $5.7 million, or 27.4%, compared to Q3 FY2018, reflecting increased personnel expenses and professional fees.

1 We calculate constant currency growth percentages by translating our prior-period financial results using the current period average currency exchange rates and comparing these amounts to our current period reported results.

Sales and marketing expense increased $0.7 million, or 1.1%, in Q3 FY2019 compared to Q3 FY2018. However, the mix of spend shifted on a year-over-year basis. Marketing campaign related spend to support the introduction of Google Assistant and our Brilliant Sound brand launch increased 31%, offset by a 21% reduction in personnel related expense. As compared to Q3 FY2018, sales and marketing expense in Q3 FY2019 declined as a percentage of revenue by 5.6 percentage points to 23.6% of revenue.

Q&A conference call webcast – 5 p.m. EST on August 7, 2019

The Company will host a webcast of its conference call and Q&A related to Q3 FY2019 results on August 7, 2019 at 5:00 p.m. Eastern Time (2:00 p.m. Pacific Time). Participants may access the live webcast in listen-only mode on the Sonos investor relations website at https://investors.sonos.com/news-and-events/default.aspx. An archived webcast of the conference call will also be available at https://investors.sonos.com/news-and-events/default.aspx following the call. The conference call may also be accessed by dialing (877) 683-0503, with conference ID 9298402. Participants outside the U.S. can dial toll-free (647) 689-5442.

Condensed consolidated statements of operations and comprehensive income (loss)

(unaudited, in thousands, except share and per share amounts)

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
Revenue	$ 260,119	$ 208,398	$ 966,663	$ 864,069
Cost of revenue	142,749	112,909	563,591	491,037
Gross profit	117,370	95,489	403,072	373,032
Operating expenses				
Research and development	44,355	35,444	121,530	104,209
Sales and marketing	61,482	60,819	176,705	214,077
General and administrative	26,583	20,860	74,308	63,822
Total operating expenses	132,420	117,123	372,543	382,108
Operating income (loss)	(15,050)	(21,634)	30,529	(9,076)
Other income (expense), net				
Interest income (expense), net	806	(1,116)	1,019	(3,367)
Other income (expense), net	1,068	(3,744)	(3,640)	(315)
Total other income (expense), net	1,874	(4,860)	(2,621)	(3,682)
Income (loss) before provision for income taxes	(13,176)	(26,494)	27,908	(12,758)
Provision for income taxes	833	494	3,074	1,126
Net income (loss)	$ (14,009)	$ (26,988)	$ 24,834	$ (13,884)
Net income (loss) attributable to common stockholders:				
Basic	$ (14,009)	$ (26,988)	$ 24,834	$ (13,884)
Diluted	$ (14,009)	$ (26,988)	$ 24,834	$ (13,884)
Net income (loss) per share attributable to common stockholders:				
Basic	$ (0.13)	$ (0.45)	$ 0.24	$ (0.23)
Diluted	$ (0.13)	$ (0.45)	$ 0.22	$ (0.23)
Weighted-average shares used in computing net income (loss) per share attributable to common stockholders:				
Basic	105,522,313	60,074,763	102,667,316	59,484,761
Diluted	105,522,313	60,074,763	112,542,998	59,484,761
Total comprehensive income (loss)				
Net income (loss)	$ (14,009)	$ (26,988)	$ 24,834	$ (13,884)
Change in foreign currency translation adjustment, net of tax	(663)	162	506	523
Comprehensive income (loss)	$ (14,672)	$ (26,826)	$ 25,340	$ (13,361)

Condensed consolidated balance sheets

(unaudited, dollars in thousands, except par values)

	As of	
	June 29, 2019	September 29, 2018
Assets		
Current assets:		
Cash and cash equivalents	$ 338,292	$ 220,930
Restricted cash	186	190
Accounts receivable, net of allowances	91,333	73,214
Inventories	121,225	193,193
Prepaids and other current assets	15,363	10,073
Total current assets	566,399	497,600
Property and equipment, net	72,856	85,371
Deferred tax assets	1,056	941
Other noncurrent assets	3,607	3,586
Total assets	$ 643,918	$ 587,498
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$ 153,478	$ 195,159
Accrued expenses	46,562	38,687
Accrued compensation	34,300	33,371
Short-term debt	11,667	6,667
Deferred revenue	13,349	11,615
Other current liabilities	16,146	10,858
Total current liabilities	275,502	296,357
Long-term debt	28,154	33,097
Deferred revenue	42,757	39,352
Other noncurrent liabilities	9,080	10,334
Total liabilities	355,493	379,140
Stockholders' equity:		
Common stock, $0.001 par value	107	101
Treasury stock	(11,904)	(11,072)
Additional paid-in capital	480,170	424,617
Accumulated deficit	(178,777)	(203,611)
Accumulated other comprehensive loss	(1,171)	(1,677)
Total stockholders' equity:	288,425	208,358
Total liabilities and stockholders' equity:	$ 643,918	$ 587,498

Condensed consolidated statements of cash flows

(unaudited, in thousands)

	Nine Months Ended	
	June 29, 2019	June 30, 2018
Cash flows from operating activities		
Net income (loss)	$ 24,834	$ (13,884)
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation	27,403	28,647
Stock-based compensation expense	33,525	29,397
Other	1,962	639
Deferred income taxes	(129)	117
Foreign currency transaction gain	1,430	301
Changes in operating assets and liabilities:		
Accounts receivable, net	(19,114)	(5,659)
Inventories, net	69,683	(79)
Other assets	(5,434)	(4,901)
Accounts payable and accrued expenses	(33,680)	(24,357)
Accrued compensation	1,091	(4,237)
Deferred revenue	5,279	10,342
Other liabilities	4,086	(534)
Net cash provided by operating activities	110,936	15,792
Cash flows from investing activities		
Purchases of property and equipment	(14,092)	(25,927)
Net cash used in investing activities	(14,092)	(25,927)
Cash flows from financing activities		
Proceeds from borrowings, net of borrowing costs	—	30,000
Repayments of borrowings	—	(30,000)
Payments for purchase of treasury stock	(832)	(911)
Proceeds from exercise of common stock options	22,034	5,748
Payments of offering costs	(585)	(2,154)
Net cash provided by financing activities	20,617	2,683
Effect of exchange rate changes on cash, cash equivalents and restricted cash	(103)	1,289
Net increase (decrease) in cash, cash equivalents and restricted cash	117,358	(6,163)
Cash, cash equivalents and restricted cash		
Beginning of period	221,120	130,788
End of period	$ 338,478	$ 124,625
Supplemental disclosure		
Cash paid for interest	$ 1,334	$ 3,596
Cash paid for taxes, net of refunds	$ 2,534	$ 1,251
Supplemental disclosure of non-cash investing and financing activities		
Purchases of property and equipment in accounts payable and accrued expenses	$ 6,053	$ 7,187
Deferred offering costs in accounts payable and accrued expenses	$ —	$ 972

Stock-based compensation

(unaudited, in thousands)

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
Cost of revenue	$ 298	$ 49	$ 701	$ 156
Research and development	4,904	3,651	12,792	10,417
Sales and marketing	3,608	4,391	9,416	12,414
General and administrative	4,598	2,242	10,616	6,410
Total stock-based compensation expense	$ 13,408	$ 10,333	$ 33,525	$ 29,397

Non-GAAP reconciliation

(unaudited, dollars in thousands)

	Three Months Ended		Nine Months Ended	
	June 29, 2019	June 30, 2018	June 29, 2019	June 30, 2018
(in thousands, except percentages)				
Net income (loss)	$ (14,009)	$ (26,988)	$ 24,834	$ (13,884)
Depreciation	8,439	9,760	27,403	28,647
Stock-based compensation expense	13,408	10,333	33,525	29,397
Interest (income) expense, net	(806)	1,116	(1,019)	3,367
Other (income) expense, net	(1,068)	3,744	3,640	315
Provision for income taxes	833	494	3,074	1,126
Adjusted EBITDA	$ 6,797	$ (1,541)	$ 91,457	$ 48,968
Revenue	$ 260,119	$ 208,398	$ 966,663	$ 864,069
Adjusted EBITDA margin	2.6%	(0.7)%	9.5%	5.7%

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Use of non-GAAP measures

We have provided in this letter financial information that has not been prepared in accordance with generally accepted accounting principles ("U.S. GAAP"). These non-GAAP financial measures are not based on any standardized methodology prescribed by U.S. GAAP and are not necessarily comparable to similarly titled measures presented by other companies.

We use these non-GAAP financial measures to evaluate our operating performance and trends and make planning decisions. We believe that these non-GAAP financial measures help identify underlying trends in our business that could otherwise be masked by the effect of the expenses and other items that we exclude in these non-GAAP financial measures. Accordingly, we believe that these non-GAAP financial measures provide useful information to investors and others in understanding and evaluating our operating results, enhancing the overall understanding of our past performance and future prospects, and allowing for greater transparency with respect to a key financial metric used by our management in its financial and operational decision-making.

Non-GAAP financial measures should not be considered in isolation of, or as an alternative to, measures prepared in accordance with U.S. GAAP. Investors are encouraged to review the reconciliation of these non-GAAP financial measures to their nearest U.S. GAAP financial equivalents provided in the financial statement tables above.

We define adjusted EBITDA as net income (loss) adjusted to exclude the impact of depreciation, stock-based compensation expense, interest expense, net, other income (expense), net and provision for (benefit from) income taxes. We define adjusted EBITDA margin as adjusted EBITDA divided by revenue.

We do not provide a reconciliation of forward-looking non-GAAP financial measures to their comparable GAAP financial measures because we cannot do so without unreasonable effort due to unavailability of information needed to calculate reconciling items and due to the variability, complexity and limited visibility of the adjusting items that would be excluded from the non-GAAP financial measures in future periods. When planning, forecasting and analyzing future periods, we do so primarily on a non-GAAP basis without preparing a GAAP analysis as that would require estimates for items such as stock-based compensation, which is inherently difficult to predict with reasonable accuracy. Stock-based compensation expense is difficult to estimate because it depends on our future hiring and retention needs, as well as the future fair market value of our common stock, all of which are difficult to predict and subject to constant change. In addition, for purposes of setting annual guidance, it would be difficult to quantify stock-based compensation expense for the year with reasonable accuracy in the current quarter. As a result, we do not believe that a GAAP reconciliation would provide meaningful supplemental information about our outlook.

Forward looking statements

This letter contains forward-looking statements that involve risks and uncertainties. These forward-looking statements include statements regarding our outlook for the fiscal year ending September 28, 2019 and long-term outlook, long-term focus, financial, growth and business strategies and opportunities, growth metrics, product launches, new partnerships and platform features, improvements in profitability and gross margins and other factors affecting variability in our financial results. These forward-looking statements are only predictions and may differ materially from actual results due to a variety of factors, including, but not limited to our ability to successfully introduce new products and maintain the success of our existing products; the success of our financial, growth and business strategies; the success of new partnerships and additions to our platform; our ability to meet growth targets; our ability to reduce costs and to cost-effectively improve our products; the success of our efforts to expand our direct-to-consumer channel and improve brand awareness; our expectations of seasonality and other factors causing variability in our financial results; our ability to manage our international expansion; tariffs on imports; and the other risk factors set forth under the caption "Risk Factors" in our Quarterly Report on Form 10-Q for the fiscal quarter ended March 30, 2019 and our other filings filed with the Securities and Exchange Commission (the "SEC"), copies of which are available free of charge at the SEC's website at www.sec.gov or upon request from our investor relations department. All forward-looking statements herein reflect our opinions only as of the date of this letter, and we undertake no obligation, and expressly disclaim any obligation, to update forward-looking statements herein in light of new information or future events.