Trickle Research

Every raging river, every great lake, every deep blue sea starts … with a trickle

Q2F25 Earnings Update

ALLIANCE ENTERTAINMENT

Alliance Entertainment Holding Corporation

(Nasdaq: AENT)

Report Date: 02/19/25

12- 24 month Price Target: $6.00

Allocation: 4

Closing Stock Price at Initiation (Closing Px: 05/06/24): $2.00

Closing Stock Price at Target Upgrade (Closing Px: 09/19/24): $2.04

Closing Stock Price at Target Upgrade (Closing Px: 11/19/24): $3.95

Closing Stock Price at This Update (Closing Px: 11/19/24): $4.85

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Disclosure: Portions of this report are excerpted from Alliance Entertainment's filings, website(s), presentations or other public collateral. We have attempted to identify those excerpts by *italicizing* them in the text.

For Q1F25 (ended 12/310/24) Alliance reported revenues of $394 million, Net Income of $7.1 million and fully diluted EPS of $.14. Those results compare to our estimates for revenues of $421 million, Net Income of $17.7, million and fully diluted EPS of $.35. After beating our estimates the two prior quarters, this quarter came in *well below* our estimates. **Table 1.** below reflects the product mix and the corresponding differences in each for both the quarterly year-over-year results as well as the 2QF25 results versus our estimates of the same:

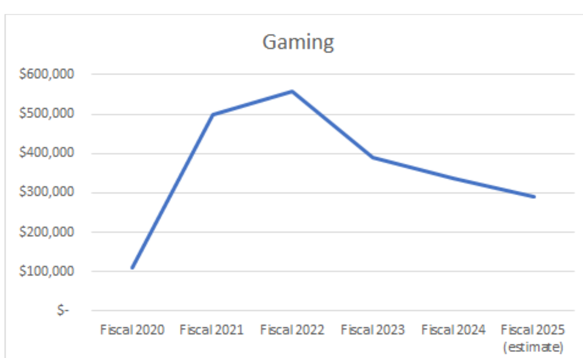
Table 1.

	Column 1 12/31/23 Actual	Column 2 12/31/24 Actual	Column 3 YoY Variance	Column 4 Trickle 12/31/24 Estimate	Column 5 Estimate Variance
Gaming	$ 191,560	$ 139,921	$ (51,639)	$ 188,385	$ (48,464)
Vinyl	$ 96,733	$ 109,064	$ 12,331	$ 96,491	$ 12,573
DVD/Blu-Ray/Ultra HD	$ 66,690	$ 82,232	$ 15,542	$ 66,568	$ 15,664
CD	$ 38,249	$ 39,025	$ 776	$ 36,518	$ 2,507
Collectibles/Toys/Consumer Products	$ 15,745	$ 11,746	$ (3,999)	$ 15,706	$ (3,960)
Freight	$ 5,499	$ 4,241	$ (1,258)	$ 5,329	$ (1,088)
Exclusive Distribution Fees	$ 5,377	$ 5,618	$ 241	$ 5,517	$ 101
Digital Delivery	$ 5,732	$ 1,827	$ (3,905)	$ 6,802	$ (4,975)
Total	$ 425,585	$ 393,674	$ (31,911)	$ 421,315	$ (27,641)

Looking at the table above, the shortfall for the quarter clearly came from the Gaming segment, and to a lesser degree, collectibles and digital delivery. Frankly, as we have suggested before, we do not feel like we have a good handle on projecting Digital Delivery, but it is a small piece of the math. Further, while collectibles underperformed our estimate as well, this is the Company's newest segment, so that alone makes this a bit harder to project as well. Going forward, Collectibles should get a boost from the newly acquired Handmade by Robots business, which we have attempted to rationalize in terms of the potential contribution going forward. Briefly, the other legacy segments of the business, Vinyl(s) and DVD/CD, posted extraordinary results. Ove the past 10 months (which is the extent of the quarterly historic segment data we have) each of these segments posted record results in the quarter. We have alluded to this in the past, but our general approach here has been to assume shrinking contributions from CD/DVD sales, but the Company's results continue to defy that notion and we are rethinking that in terms of our modeling. That brings us back to the big miss for the quarter; gaming.

In retrospect, the gaming industry has been contracting since the boom created by the pandemic, and Alliance's relative results have followed suit:

Table 2.



Recognize, that fact was not lost in our modeling. As **Table 1** reflects, we had projected lower YoY gaming revenues for 2QF25 versus 2QF24 (which was effectively the 2024 holiday buying season versus the 2023 holiday buying season). Succinctly, the magnitude of that miss was far greater than we anticipated and frankly was surprising and provides an element of visibility (or lack thereof) that thought we had a better handle on. That said, industry narrative we have read seems to suggest that while many expect the industry to perform better (or less badly) than it has over the past two years, the ongoing expectation is for far more moderate and perhaps normalized growth. Some of that narrative also notes that the industry was negatively impacted by some more micro industry issues (delays or timing of new platforms etc.) that may boost some of the coming year-over-year comps. The gist of all of that from our end, is that while again, our estimates for fiscal 2026 gaming growth over fiscal 2025 were modest (about 4%), the fact that F2025 numbers will now likely be *well below* the prior estimate, have led us to adjust our new assessments for F2026 (and beyond) gaming revenues lower.

Beyond gaming, as we alluded to above, we also made some adjustments to some of the other revenue streams in conjunction with new data therein. Further, since our last model update, the Company has added two new significant pieces of business, the acquisition of collectibles platform Handmade by Robots, and a new home entertainment license agreement with Paramount Pictures, making Alliance *"the exclusive distributor of Paramount's physical media, including DVD, Blu-ray, 4K and UHD, across the U.S. and Canada".* We expect each of those developments to be additive to their respective segments beyond our prior estimates.

Lastly, while gaming revenues disappointed, the Company continues to drive efficiencies and drive down unit costs. Despite lower aggregate revenues, Distribution and Fulfillment margins were about 35 basis points better than our projections. Further, SG&A came in at about $330,000 lower than our estimates as well. We would add, the quarter also included a non-cash charge for a change in fair value of warrants, which had an EPS impact of around <$.05>. We did not model that.

To summarize, the quarter was disappointing overall, led by markedly lower gaming revenues offset in part by meaningful upside surprises in Vinyl and CD/DVD and further gains from operating efficiencies. Unfortunately, gaming has historically carried better margins than CD/DVD sales, so the earnings impact of the gaming miss was exacerbated on the bottom line as well. That said, on the call, it is clear that management remains quite optimistic about their prospects, and we think that includes gaming, so while we have crammed down our estimates, it will not surprise us if they can surprise to the upside again.

Despite the miss, we remain constructive on Alliance's prospects, and as such we reiterate our Allocation of 4 and our 12-24 month price target of $6.00. As those following the Company are aware, and as the chart above reflects, the stock has already breached our price target in several occasions, which in our case typically results in either a target increase, an allocation downgrade or coverage termination. Our thinking in that regard is that we are likely to increase our price target moving forward if they continue to perform in line with our model assumptions. Succinctly, setting aside this quarters miss and some of the associated issues we noted, our view is that their overall strong financial performance since the time we started researching and then ultimately initiating the coverage has derisked the story, which we think justifies lower risk discounts and in turn higher price targets. We will hold that card for now but that is our general view of our price target relative to the current price of the shares. We will reassess our conclusions as new information emerges.

Projected Operating Model

Alliance Entertainment Holdings Corp.						
Projected Operating Model ('000's)						
By: Trickle Research						
	(Actual)	(Actual)	(Estimate)	(Estimate)	(Estimate)	(Estimate)
	09/30/24	12/31/24	03/31/25	06/30/25	Fiscal 2025	Fiscal 2026
Net Revenues	$ 228,990	$ 393,674	$ 210,648	$ 241,891	$ 1,075,203	$ 1,111,670
Cost of Revenues (excluding depreciation and amortization)	$ 203,455	$ 351,382	$ 183,807	$ 211,008	$ 949,653	$ 969,069
Operating Expenses:						
Distribution and Fulfillment Expense	$ 9,018	$ 12,419	$ 9,056	$ 9,805	$ 40,298	$ 42,680
Selling, General and Administrative Expense	$ 13,145	$ 13,800	$ 13,616	$ 13,663	$ 54,224	$ 54,868
Depreciation and Amortization	$ 1,258	$ 1,255	$ 1,247	$ 1,247	$ 5,006	$ 4,987
Transaction Costs	$ -	$ -	$ -	$ -	$ -	$ -
IC DISC Commissions	$ -	$ -	$ -	$ -	$ -	$ -
Restructuring Cost	$ 50	$ 19	$ -	$ -	$ 69	$ -
Loss on Disposal of Fixed Assets	$ (15)	$ -	$ -	$ -	$ (15)	$ -
Total Operating Expenses	$ 23,456	$ 27,493	$ 23,918	$ 24,715	$ 99,582	$ 102,534
Operating (Loss) Income	$ 2,078	$ 14,799	$ 2,923	$ 6,168	$ 25,968	$ 40,067
Other Expenses:					$ -	$ -
Interest Expense, Net	$ 2,839	$ 2,827	$ 2,445	$ 2,530	$ 10,641	$ 9,344
Change in Fair Value of Warrants	$ -	$ 2,545	$ -	$ -	$ 2,545	$ -
Total Other Expenses	$ 2,839	$ 5,372	$ 2,445	$ 2,530	$ 13,186	$ 9,344
(Loss) Income Before Income Tax (Benefit) Expense	$ (761)	$ 9,427	$ 478	$ 3,638	$ 12,782	$ 30,723
Income Tax (Benefit) Expense	$ (1,157)	$ 2,354	$ 124	$ 946	$ 2,267	$ 7,988
Net (Loss) Income	$ 396	$ 7,073	$ 354	$ 2,692	$ 10,515	$ 22,735
Other Comprehensive Income:						
Foreign Currency Translation	$ -	$ -	$ -	$ -	$ -	$ -
Total Comprehensive (Loss) Income	$ 396	$ 7,073	$ 354	$ 2,692	$ 10,515	$ 22,735
Net (Loss) Income per Share - Basic	$ 0.01	$ 0.14	$ 0.01	$ 0.05	$ 0.21	$ 0.44
Net (Loss) Income per Share - Diluted	$ 0.01	$ 0.14	$ 0.01	$ 0.05	$ 0.21	$ 0.44
Shares Used in Computing Net Income per Share, Basic	50,957,370	51,157,370	51,357,370	51,557,370	51,257,370	52,057,370
Shares Used in Computing Net Income per Share, Diluted	50,965,970	51,165,970	51,365,970	51,565,970	51,265,970	52,065,970

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Portions of this publication excerpted from company filings or other sources are noted in *italics* and referenced throughout the report.

Rating System Overview:

There are no letters in the rating system (Buy, Sell Hold), only numbers. The numbers range from 1 to 10, with 1 representing 1 "investment unit" (for my performance purposes, 1 "investment unit" equals $250) and 10 representing 10 investment units or $2,500. Obviously, a rating of 10 would suggest that I favor the stock (at respective/current levels) more than a stock with a rating of 1. As a guideline, here is a suggestion on how to use the allocation system.

Our belief at Trickle is that the best way to participate in the micro-cap/small cap space is by employing a diversified strategy. In simple terms, that means you are generally best off owning a number of issues rather than just two or three. To that point, our goal is to have at least 20 companies under coverage at any point in time, so let's use that as a guideline. Hypothetically, if you think you would like to commit $25,000 to buying micro-cap stocks, that would assume an investment of $1000 per stock (using the diversification approach we just mentioned, and the 20-stock coverage list we suggested and leaving some room to add to positions around allocation upgrades. We generally start initial coverage stocks with an allocation of 4. Thus, at $1000 invested per stock and a typical starting allocation of 4, your "investment unit" would be the same $250 we used in the example above. Thus, if we initiate a stock at a 4, you might consider putting $1000 into the position ($250 * 4). If we later raise the allocation to 6, you might consider adding two additional units or $500 to the position. If we then reduce the allocation from 6 to 4 you might consider selling whatever number of shares you purchased with 2 of the original 4 investment units. Again, this is just a suggestion as to how you might be able to use the allocation system to manage your portfolio.

For those attached to more traditional rating systems (Buy, Sell, Hold) we would submit the following guidelines.

A Trickle rating of 1 thru 3 would best correspond to a "Hold" although we would caution that a rating in that range should not assume that the stock is necessarily riskier than a stock with a higher rating. It may carry a lower rating because the stock is trading closer to a price target we are unwilling to raise at that point. This by the way applies to all of our ratings.

A Trickle rating of 4 thru 6 might best (although not perfectly) correspond to a standard "Buy" rating.

A Trickle rating of 7 thru 10 would best correspond to a "Strong Buy" however, ratings at the higher end of that range would indicate something that we deem as quite extraordinary..... an "Extreme Buy" if you will. You will not see a lot of these.