Transcription

Q1 2024 Financial Results of Karooooo.

Karooooo Ltd (NASDAQ:KARO) Q1 2024 Earnings Conference Call July 20, 2023 8:00 AM ET

Company Participants

Zak Calisto - Founder, CEO & Director

Carmen Calisto – Group Chief Strategy and Marketing Officer

Goy Hoeshin – Group Chief Financial Officer

Conference Call Participants

Carmen Calisto

Hello and welcome to Karooooo's Financial Year 2024 Q1 earnings call. On behalf of Karooooo, we would like to thank you for joining us today.

I'm Carmen, the Group's Chief Strategy and Marketing Officer, and together with Hoeshin, our Group Chief Financial Officer, will be taking you through our strong performance and growth.

All investors are advised to read through the disclaimer.

We will be reviewing all three of Karooooo's business units in today's webinar, namely Cartrack, Carzuka and Karooooo Logistics.

VISION AND MISSION

Our mission remains to be the leading operations cloud as we persist in helping to define the future of operations. We continue to see how crucial mobility is to all operations, and how our customers derive huge value from having more than just their vehicles and equipment, but entire operational workforce connected.

Our innovative solutions are allowing customers to meet strict government compliance whilst achieving more with less.

WE SOLVE PROBLEMS

Our customers are continuously tackling challenges around their operation's efficiencies including fuel, safety, maintenance, resource scheduling and more. However, they are also increasingly facing new obstacles, from new government mandates, to carbon footprint tracking and worker retention. These all contribute to the growing demand for our platform.

Our strong track record of identifying trends and developing solutions that successfully solve customer challenges to add huge value to their daily operations is evident, and this is a strong driver for our continued strong, sustainable growth.

Through digital transformation and user-friendly tools, we offer invaluable support to customers in achieving compliance and navigating their day-to-day challenges, simplifying their operations and boosting their efficiencies.

LARGE UNDERPENERATED MARKET

Karooooo operates within massive, interconnected and mostly untapped global markets. Analysts estimate that operations contribute to over 40% of the global GDP, and as businesses recognise the importance of IoT data in enhancing their operations, the opportunities for us continue to expand.

With operations becoming more cross-functional and new government mandates arising and being enforced, the range of problems we can address is widening alongside the need for our platform, setting the stage for substantial and long-term growth ahead.

OUR CULTURE

Karooooo's ownership orientated culture is deeply entrenched in all parts of our business. Being vertically integrated has not only given us deep tangible knowledge about operations, but has allowed us to control our distribution to ensure we are able to quickly adapt to our customer's growing needs. This alongside our continuous investment in our proprietary internal solutions has fostered a customer centric culture that focuses on providing world class customer service.

We have a strong history of building scalable software that solves complex problems across different disciplines, and customers quickly understand their large return on investment from our platform. Through an ecosystem of open APIs our platform enables customers to connect with other tools to bring all their operational data into a single unified cloud where they receive actionable insights that drive huge impact.

Karooooo's constant innovation, customer centricity and ownership-orientated culture has enabled us to develop a platform that benefits from long-term stickiness, as shown by our 95% customer retention rate, and is easily implemented in small to large enterprises across a range of diverse industries.

WHY WE WIN

At the core of our success is the ability to set ourselves apart through strong execution. Our forward-looking approach delivers high ROI to customers and enables us to build a sustainable business that will benefit stakeholders for generations to come.

We have unique go-to-market strategies, strong distribution channels and place full focus on providing a great customer experience on our end-to-end operations cloud.

We have a vertically integrated business model, proprietary internal management systems and a strong entrepreneurial culture. These all come together to allow us to challenge the status quo to successfully solve problems and provide customers with a platform they can rely on as the backbone of their operations, highlighted by our increase in commercial customers to over 108,000. We continue to see no industry or customer concentration risk.

GLOBAL TRENDS DRIVING NEED & ADOPTION

Digitalisation, ESG and compliance continue to drive increased demand and adoption of our platform across all geographies. Operators crave visibility and are looking to leverage the power of IoT to gain full control over their operations. End customers and governments are increasingly focusing on net zero and putting significant pressure on our customers to reduce their carbon emissions and increase their positive impact on the community. And finally, we have seen large strides by governments to increase compliance across geographies, both in terms of new laws as well as enforcement. These are no longer negotiables.

OUR APPROACH TO ESG

Our approach to ESG successfully solves all government mandates whilst also ensuring customers drive strong operational value from their ESG initiatives.

Reducing carbon emissions by cutting fuel is clear, however our platform goes beyond to ensure customers are also focusing on other aspects of their operation such as maintenance plans to reduce their maintenance costs and in turn slash their emissions. Tracking emissions in a simple to digest format that contextualises data has enabled customers to embark on governments efforts to reduce emissions more easily.

As previously mentioned, governments are increasingly implementing sophisticated mandates that are spreading to all aspects of an operation. From driver shifts to regulatory paperwork and machinery inspections, customers rely on our easy-to-use digital tools to digitalise their operations and ensure compliance with the latest standards.

Customers are also now better equipped to tackle driver and worksite safety through gamified driver scorecards and AI cameras that reduce speeding and accidents, and increase driver wellbeing and retention as well as company brand within the community.

By interconnecting their ESG and operations, we help customers meet their ESG and compliance goals whilst cutting costs, all in all leading to increased customer ROI and stickiness.

ASIA: AN UNDERPENETRATED, FRAGMENTED MARKET WITH A MASSIVE TAM

We continue to believe that our advanced cloud platform and unrivalled service delivery position us well in Asia. The rapidly growing market remains largely underpenetrated and fragmented, and small to large business operators are increasingly looking to digitalise their operations to enhance efficiencies and competitive advantage.

Our strong growth in the segment is testament to our ability to localise our solutions and adapt to different customer cultures and needs whilst ensuring they remain reliable, effective and easy-to-use. Our solutions are robust and built for scale.

ASIA: ALSO A MARKET FLOODED WITH PIONEERING COMPANIES THAT CARE ABOUT MUCH MORE THAN JUST GPS

There are a large number of companies in Asia paving the way globally with their sophisticated approaches to their operations. Despite Asia's reputation for price sensitivity, customers are increasingly looking towards value-for-money as they continue to understand how data can revolutionise their businesses.

Some customers are focusing on improving their reputation and brand through increased safety, risk management and guaranteed service delivery.

Others are leading the way with electric vehicles, leveraging our platform to eliminate challenges around battery life and vehicle demand hotspots.

And others are powering over 10,000 daily deliveries whilst reducing fuel costs, vehicle loading downtimes and admin. They use our sophisticated APIs to connect into their ERP and other tools to get a single unified view of their complex operation.

NETWORK EFFECTS

With over 155 billion valuable data points generated monthly, and over 10% of all vehicles on the road in South Africa, Karooooo has a huge untapped network effect opportunity.

We continue to focus on using our scale advantages to benefit our customers through personalised experiences and advanced machine learning and insights. This remains aligned with our belief to drive sustained, long-term value for customers.

INVESTMENT HIGHLIGHTS

Our strong management, entrepreneurial culture and vertically integrated business model have empowered us to remain agile and adaptable, resulting in our proven track record of growth and profitability across varying macro-economic headwinds across regions.

We continue to offer a strong value proposition to customers by continuously adding new, innovative solutions to our cloud whilst also passing on the benefits of our economics of scale to our customers. Our ARPUs remain stable and our customer retention remains very high.

We have a resilient business model that is highly cash generative with strong margins and large visibility over future revenue. Our balance sheet is robust, and management continues to drive strong unit economics with sustained growth at scale.

Given the large TAM and our strong principles, we have ample runway for growth.

I will now pass over to HoeShin who will take us through our financial performance.

Goy Hoeshin

Thank you, Carmen. I will now talk through Karooooo's financial performance for Q1 FY24. Please note that all comparisons are against Q1 FY23 unless otherwise stated.

REVENUE AND EARNINGS

Our proven and profitable SaaS business model continued and delivered a solid start for the financial year.

In Q1, Karooooo's total revenue increased by 24% to ZAR 997 million. And ARR increased 20% to ZAR 3,409 million.

As expected, after substantial investment for future growth in all segments, operating profit increased marginally by 3% to ZAR 224 million and earnings per share increased 3% to ZAR 5.09.

All segments continue to see strong traction with the benefits of our strategic investments beginning to show.

ROBUST BUSINESS MODEL AND STRONG BALANCE SHEET
Our consistent results extend our track record of growth at scale, profitability and cash generation ability. Free cash flow in this quarter up by 39% to ZAR 158 million and continue to bolster our balance sheet. Net cash on hand up by 18% to ZAR 1,137 million.

In this quarter, ZAR 32 million are invested in the development of the South African Central Office and ZAR 19 million are invested in the working capital of Carzuka.

Debtor's turnover days continued to show improvement to 28 days alongside with prudent provisioning to weather off strong economic headwinds in some of the markets we are operating.

The healthy cash generation drove up net cash and cash equivalents and support future cash outflows require for future growth.

We have strong unit economics, robust operating margins, unleveraged balance sheet and a strong cash conversion. We remain confident that our track record of success, especially our ability to generate healthy cash flows, is sustainable.

EPS RECONCILIATION
Our earnings per share increased by 3% to ZAR 5.09 in this quarter. The increase is the result of positive revenue growth and improved profitability despite our prudent and strategic investment for growth.

We will now focus on Cartrack, the underlying asset to Karooooo's success:

CARTRACK EXTENDING DECADE-PLUS TRACK RECORD OF EXECUTION EXCELLENCE
Cartrack continues to prove its ability to scale in varying macro-economic conditions and consistently beaten the rule of 40.

Overall, subscribers grew at scale by 14% to 1,757,452. And in this quarter, subscription revenue grew 18% to ZAR 834 million and operating profit stood at ZAR 232 million.

CARTRACK CONTINUES WITH DECADE PLUS TRACK RECORD OF STRONG SAAS REVENUE GROWTH
As Cartrack's continue with strong SaaS revenue growth, Cartrack's total revenue grew 18% to ZAR 853 million.

Cartrack's total subscription revenue represents 98% of total revenue, which is in line with our SaaS business model.

With mentioning, our SaaS ARR grew 20% to ZAR 3,401 million.

The strong performance of Cartrack was largely supported by demand of small to large enterprises wanting to improve its compliance functions and to digitally transform their business to become more efficient and competitive.

CARTRACK IMPROVES OPERATING PROFIT DESPITE STRONG INVESTMENT FOR GROWTH

As Cartrack continues to have strong visibility of its future SaaS revenue, our realisation of economies of scale continue to demonstrate our ability to drive earnings.

Gross profit in this quarter increased by 16% to ZAR 600 million.

Despite the investment for growth, our operating profit increased by 5% to ZAR 232 million.

In this quarter, we increased our headcount both in sales and G&A.

We are building strong support and distribution capabilities as we expand in our territories.

Our Adjusted EBITDA up by 10% to ZAR 392 million.

CARTRACK'S CUSTOMER ACQUISITION AND UNIT ECONOMICS

Cartrack's low cost of acquiring a customer, high customer lifetime value and retention rate as well as strong benefits from economies of scale result in our leading unit economics.

Our LTV to CAC is over 9.

We have strong profit margins with our gross profit margin on subscription revenue at 71% and commercial customer retention rate of 95%.

Whilst we remain prudent with our capital allocation, we started our hiring drive in Q1 for territorial expansion and growth of the business.

CARTRACK'S STRONG SUBSCRIBER UNIT ECONOMICS

Over the years, Cartrack has maintained a steady ARPU and average upfront cost of acquiring a subscriber.

ARPU for the quarter was ZAR 160.

Cartrack's average lifetime revenue per subscriber increased to ZAR 9,604 in this quarter.

The average up front cost of adding a subscriber to our cloud in this quarter was ZAR 2,363. These costs, mainly relates to sales commission and telematic devices which are capitalized and sales and marketing expenses that are expensed off.

The headroom, derived from the average lifetime revenue per subscriber, after subtracting the average upfront cost of adding a subscriber was, ZAR 7,241 per subscriber.

From the ZAR 7,241, we incur the cost to service a subscriber over the contract life cycle of 60 months.
The cost to service a subscriber decreases as we grow our subscriber base.

Our unit economics have remained steady allowing us strong operating profits.

CARTRACK CONTINUES TO GROW SUBSCRIBERS BASE & ARR WITH ENCOURAGING TRACTION IN SEA
Cartrack continues to grow its subscribers base and ARR to expand in all geographies.

The South African economy remains under pressure as a result of continuing strain on the national power grid. Despite the challenging trading conditions, our subscribers grew by 13%.

In Asia, the Middle East and USA, subscribers grew by 24% as the traction in South East Asia has been encouraging. South East Asia remain as the second largest contributor to the group's revenue, presenting the most compelling growth opportunity to the Group in medium to long term.

Europe saw a healthy growth of 12% and remains a region we are focusing our resources on. With our recent partnership with leading OEMs, we are poised to leverage our extensive offerings to further develop the connected-vehicle ecosystem and expect these partnerships to contribute to our results in medium term.

Africa other maintained its growth with 7% increase in subscribers.

At the end of quarter 1, our ARR increased 20% to ZAR 3,401 million.

This is at a good trending as we continue to see the momentum of growth in our subscribers and ARR.

CARTRACK ROBUST OPERATING METRICS
Cartrack continues to have robust operating margins and our trends are in line with the long-term financial goals set out upon our listing in 2021.

In this quarter, our subscription revenue gross profit margin stood at 71% which is consistent with our expectation.

Research and development expenses as a % of subscription revenue are 6%.

With the start of our hiring drive in Q1, we prudently invest into sales and marketing headcounts to drive our territorial expansion and growth and as a results sales & marketing expenses as a % of subscription revenue increase to 14%.

General and admin expenses as a % of subscription revenue are at 21% and will continue to improve as we remain pragmatic in our operating expenses.

Operating profit as at % of subscription revenue are 28% and our adjusted EBITDA as a % of subscription revenue at 47%.

CARTRACK'S OUTLOOK FOR 2024
We have had a solid start to our financial year 2024.

Our guidance for Cartrack's outlook remains unchanged with number of subscribers – between 1.9 to 2.1 million.

Cartrack's subscription revenue - between ZAR 3.4 to ZAR 3.6 million.

Cartrack's Operating Profit Margin - between 28 to 31%.

CARZUKA & KAROOOOO LOGISTICS CONTINUE TO GAIN TRACTION
Carzuka and Karooooo Logistics continue to gain traction and bolster Karooooo's revenue growth.

Most segments showed good progress with strong quarter 1 growth.

Carzuka delivered ZAR 82 million in revenue in this quarter. This growth continues to support our belief in the sustainability of its agile, data-enhanced and highly scalable business model. It is also a testament of Karooooo's customer-centric innovation in solving unique mobility needs.

While it is at an operating loss as we carry on to invest in the infrastructure and brand building, we will also focus in refining our internal processes to improvise the efficacy and being pragmatic in our spending.

We consider this an asset-light investment and once Carzuka's revenue exceeds ZAR 300 million per quarter, we believe the business will give us the return we expect.

Karooooo Logistics delivered significant growth generating ZAR 62 million in revenue and an encouraging operating profit of ZAR 5 million in this quarter.

Its focus on delivery-as-a-service ("DaaS") has gained momentum while it continued to integrate into Cartrack's platform to expand its customers based. The Karooooo Logistic stack is expected to deliver a long-term revenue stream to the Group.

I would like to thank everybody for joining us today and will now open the floor to Q&A with our Group CEO and founder Mr. Zak Calisto.

<u>Question-and-Answer Session</u>

Zak Calisto

Thank you very much for joining us today.

Question: Matthew Pfau, William Blair

How have subscriber additions trended in June and July relative to the first quarter? Any improvement?

A – Zak Calisto

Certainly, we've had a much stronger June and July compared to the first three months of the financial year. So this quarter, we are hoping to see a substantially better quarter than the previous year in terms of subscriber additions.

Question: Matthew Pfau, William Blair

Which expense lines do you anticipate to show the most leverage throughout the year so that the Cartrack segment can hit its operating profit margin target?

A – Zak Calisto

In the first quarter, we've spent a substantial amount of money in terms of recruiting people for support which falls under G and A. We will continue in Q2 to also recruit and add more headcount and I believe G and A is the amount that will then taper off and allow us to meet our targets. I certainly believe we are on track going in accordance with budgets and to meet our targets.

Question: Parker Lane, Stifel

How should we think about the balance of growth and profitability over the medium to long-term, as Carzuka and Karooooo Logistics continue to scale.

A – Zak Calisto

I think one needs to see these three different segments in isolation, they've got very different margins. On the consolidated numbers, that's going to affect our margins. I see Carzuka reaching break-even in the short-term, and I see Karooooo Logistics that is already profitable continue to scale that. For a very long time to come, Cartrack will certainly be the driving force of our operating profits.

Question: Matthew, Confluence Impact Fund

Two areas I would like to understand better: 1) the change in capitalisation of costs - and the resulting lower reported EBITDA. What were the nature of these costs? Why are they now being expensed? Is there a way that we can better understand comparable reporting for historical periods? 2) Asian growth. Which markets are responsible for the growth in Asia? How is the sales / marketing set up there? Are you happy that you will be able to sustain 20%+ growth in this geography?

A – Zak Calisto

There is no change in the way we capitalize costs, that is something that is not discretionary but required by IFRS. What has changed is what we have seen is a huge increase in marketing costs and which are expensed upfront. And with this, they obviously affect our operating profit. As Hoeshin took us through the unit economics, you can also see the higher ARPU and we will drive more value out of each subscriber and it will offset that initial cost that we do have upfront that is affecting us. So we will reap the benefits going into the future.

The only way we can better understand comparable reporting for historical periods is by either cash accounting – in terms of cash accounting what we see is our break-even of the costs we occur upfront has remained constant. I have not got the exact number on me, but it is around 22 or 23 months. So despite the total costs going up, given the ARPU and lower cost to service each vehicle on our platform every month, we have a breakeven point that's remained fairly constant historically.

Asia growth, clearly we are gaining strong momentum in Singapore and certainly the market leaders in Singapore. We're getting really good momentum in the Philippines, Indonesia and Thailand at this stage.

We have the same marketing set-up throughout all the geographies that we operate in.

We certainly believe 20% growth to be a very low growth in Asia, and clearly with Covid that was very difficult. I think the year post-Covid was difficult but for different reasons. I think the job market was quite difficult. I think we are now starting to get the momentum we need and I certainly believe we'll grow much faster than we currently are.

Question: Sebastiaan

Can you comment further on the higher proportion of Costs Acquiring a Subscriber that was expensed in the quarter. What drives this figure? Is this due to customers cancelling their contract prior to the depreciation period of the tracking device?

A – Zak Calisto

What drives the figure is really what it costs us to put a vehicle on our Cloud. The portion of those costs we expense upfront, which is the sales, salaries and marketing costs. And the other costs we capitalise, which is the IoT devices, technicians and commissions paid. This is a IFRS rule and how to do the accounting for it.

It has nothing to do with customer's cancelling. What customer's cancelling will do is it will reduce your customer retention and it will also reduce your lifecycle of a vehicle on your cloud. We've consistently been at over 60 months, and this is an actuarial calculation.

Question: Alexander Sklar, Raymond James

SE Asia growth continuing well above the company average, how much go-to-market investment are you putting behind the current momentum in that region?

A – Zak Calisto

Our biggest capital allocation continues still to be South Africa, but as a proportion that is decreasing and South East Asia is increasing substantially. We did see an increase in capital allocation in South East Asia in Q1 this year.

Question: Alexander Sklar, Raymond James

It hasn't historically been a focus, but what are your latest thoughts around pricing and the ability to push pricing as a growth driver?

A – Zak Calisto

Our pricing model is very much around our unit economics and while we are having operating profits in the region of 30% in terms of our P&L, we believe there is no need to drive up our pricing. We are getting great benefits from the economies of scale. Our ability to drive up pricing was tested last year and we believe that should it be necessary, we certainly have a lot of elasticity to push up pricing. Given that we are continuously adding stack to our platform, and if one had to take the route of everytime you add a new stack you enhance the platform, we can go to the market and upsell. I believe we can do that should it be necessary.

Question: Rudi Van Niekerk, Desert Lion Capital

You are evidently spending for future growth, for example the hiring drive. Typically, how many months does it take before this spending starts to translate into commensurate revenue growth?

A – Zak Calisto

It's typically 6 months until you see the effects of the investment. What I've learnt is that you invest and the real benefits come 2-3 years later. With bringing new staff on board it takes around 6 months for them to settle, most only start adding real value after 24 months. But you do start seeing value after 6 months.

Question: Gokul Raj

With a low base in Asia and Europe, should we not expect a higher growth rate than what the firm has delivered currently?

A – Zak Calisto

I believe so, and we will be driving that. Our commitment now is to grow Asia and Europe faster.

Question: Khanh Ho

The number of net additions in subscribers slowed down to 25 000 in South Africa for this quarter and last quarter. What are the reasons for this?

A – Zak Calisto

South Africa at the moment has a few challenges, it's a resilient country and every so often it goes through these challenges. One of the biggest challenges now is the stress on the electricity grid and obviously that's having quite a negative effect on the economy.

Question: Khotso Mophosho, Coronation

How did you manage to grow subs in SA? is it increased market share, or higher industry penetration?

A – Zak Calisto

We don't have the full market statistics to be able to answer with the degree of confidence that I'd like. It is a combination of market share and higher industry concentration.

Question: Prashant Premkumar

Can you please provide some context on ESG/carbon footprint monitoring being a driver for our growth? What are some of the specific government regulations driving adoption and in which geographies?

A – Zak Calisto

There's a lot of talk about ESG and there's positive movements in this direction. We're seeing government legislation starting to come through in many geographies for compliance. One good example in Europe is eTacograph, which will be used in sedan vehicles. We're looking to get real benefit out of that. With ESG, we are well positioned to help corporates report on many of the ESG aspects. We certainly believe that will become stronger and stronger drive for our growth.

Question: Chris

Well done on a credible performance. Samsara is making much out of utilizing Artificial Intelligence to improve safety and efficiency and their general AI innovation. Is this an area Karooooo sees potential in?

A – Zak Calisto

The word Artificial Intelligence is the word of the day. I think Artificial Intelligence has been with us for 20 years. Certainly, in last three to four years we've seen a huge exponential growth in the maths behind it. We've been doing it for many years, and if you look at our platform offering it will be quite evident that we are driving the benefits that are coming from good algorithms, data collection and presentation. That's fundamentally what Artificial Intelligence is, so it really is just a buzz word that's being used very loosely. I certainly believe we are very much involved in delivering Artificial Intelligence and continue to improve on that aspect of our business.

Question: Myles Fourie

Is subscription growth outside of Africa taking longer and costing more than anticipated since Covid-19?

A – Zak Calisto

It's certainly taking longer, but costing more I don't think that is necessarily the case. But outside of Africa, what we did see specifically is the last FY23 very turbulent and difficult to hire people. That's starting to normalise in Q1 and Q2, and we believe that once we get the necessary momentum with the hiring then we will reap the results in the revenue growth.

Question: Myles Fourie

How is trading going outside of Africa in Q2 off a low base relative to TAM?

A – Zak Calisto

We are having a stronger Q2.

Question: Myles Fourie

What are the inhibitors to doubling subscribers?

A – Zak Calisto

It is just the ability to distribute and we are very focused on increasing our distribution capabilities.

Question: Myles Fourie

What EBITDA % will Carzuka achieve on quarterly revenues of R300m? I understood from previous presentations that it was breakeven but today's presentation indicates acceptable returns.

A – Zak Calisto

We're looking at once we get to 300million we will probably be sitting on an operating profit of around 4-5%.

END

Thank you for joining us today. Please email us with any further questions at ir@karooooo.com.