Transcription

Q2 and Half-Year 2024 Financial Results of Karooooo.

Karooooo Ltd (NASDAQ:KARO) Q2 and Half-Year 2024 Earnings Conference Call October 12, 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 Q2 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 business updates and financials.

DISCLAIMER
All investors are advised to read through the disclaimer

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

SETTING THE PATH FOR TOMORROW
Karooooo continues to believe in our mission to be the leading operations cloud, and we see how we are helping to set the path for tomorrow for operational businesses with our platform. Industry leading customers consult with us on how to improve their operations and tackle their day-to-day challenges, and our ability to think beyond connected vehicles and equipment has been pivotal in delivering a cloud that connects an entire operation in one place to achieve real business impact.

DIGITALLY TRANSFORM OPERATIONS
Despite the varying macro-economic environments we encountered, digitalisation, ESG and compliance continue to be strong drivers for demand of our platform.

Our platform offers the flexibility customers need to digitalise their operation at their own pace, and in a way that makes sense for them. Whether it is digital forms that facilitate workers and drivers to complete their workflows effectively via a mobile app, coaching solutions that generate success and provide accountability, risk management tools that enable quick resolutions and full audit trails, automated carbon emission reporting and progress tracking or detailed productivity reporting for optimised operations- our platform fits into an operation for success. Additionally, customers can integrate with their existing tools such as fuel card providers and ERPs to further curate insights that suit their needs.

By partnering with our customers to understand their operation and help tackle their challenges, we get deep insider knowledge to continue adding innovative features to our platform to further increase the value customers get from our platform, and the importance we play in optimising their operation.
Our platform brings both operational and non-operational teams together, and helps companies remain compliant, competitive in their industries and most importantly- forward thinking.

EASY TO USE SOLUTION
To illustrate how our platform impacts a customers operation, we can take a look into an existing customer. A large furniture manufacturer that delivers their own goods needed a way to alleviate their administrative burden whilst improving their operations. With delivery fees often impacting a customer's decision to buy, offering competitive rates was critical to their operation.

After 10 days of implementing our delivery management tool, our customer saw returns at large. With our easy-to-use solution that optimises all jobs across drivers and provides optimal routes, as well as a practical mobile app for drivers to receive everything they need to excel at their job our customer successfully saved 4 litres of diesel per vehicle per day. With this reduction, they are on track to exceeded their sustainability goals and reducing their carbon emissions by over 2,800kg per vehicle per year.

The payback period of our solution is under 3 days and the ROI is over 700%, and this is purely looking at the fuel cost savings. If we were to account for the manpower costs saved on dispatching and managing drivers, as well as communicating with customers and collecting payment after delivery with our electronic proof of delivery, ROI would further increase. This goes to highlight Karooooo's strong value proposition and the impact our cloud platform has in streamlining operations, lowering environmental impact and helping businesses thrive in a more robust and competitive business landscape.

AI VIDEO
The same way reaching for a phone has become second nature to society, many drivers are unaware of their actions as well as the risks these actions have on their safety- what feels like half a second of screen time is actually 5, or a harmless yawn is actually the first sign of falling asleep at the wheel. Beyond harsh driving behaviour detected by telemetry, AI cameras have given a new dimension to both managers and drivers to overcome high risk driving behaviour. Real-time audible alerts have proven critical in enabling drivers to correct their behaviour in real-time to avoid collisions and accidents. Whilst with total visibility of events that previously went undetected, managers are now equipped to establish effective training programs and monitor the progress of drivers towards a safety-first working environment. AI cameras allow for a preventative, and proactive approach to safety.

A customer that transports fuel has seen a 46% decrease in high-risk behaviour events detected by our AI after 3 calendar months of implementation. These events include fatigue, mobile phone usage, other distracted driving and tailgating. An accident with a vehicle carrying such sensitive cargo is not only detrimental to drivers lives, but also can cause vast negative public relations that can have long-lasting negative effects on a business. Avoiding these high risk events reduces accidents, and implementing this technology has enhanced our customer's reputation for strong service delivery which has led to increased business growth.

The benefits of increased safety are far reaching. Not only does this lead to safer communities and better working environments, but it reduces costs substantially through reduced accident repairs, maintenance fees and insurance premiums. Drivers feel more loyal to companies as they feel the fruits of the investment, and end-customers feel more confident in the ability of our customers to exceed expectations.

We encourage companies to work with their drivers by investing in their coaching and education, and as the benefits and success of these solutions gain traction, we believe we will continue to see increased government mandates around the implementation of this technology as a means to increase safety for communities.

OVER 113,000 CUSTOMERS POWER OPERATION

Our robust customer growth across industries is testament to our proven business model, competitive differentiators and strong financial position, and we continue to see no customer or industry concentration risk.

With over a decade of insights into operations and how our customers work, we are able to pinpoint what will drive business value and are incorporating AI and machine learning into platform to enhance our solution. From accident and fuel fraud detection, to industry insights and benchmarks, our customers are reaping the benefits from our vast data scale and network effects, and we will continuously enhance our platform to further increase these benefits.

Our progress remains aligned with our ethos, and long-term strategy to drive unparalleled value to the day to day operations. There is ample runway for growth, and our team is motivated to deliver on it.

CARTRACK DNA

The investor community at large has continued to ask many questions around our culture and teams. We understand that running an operation the way we do is no small feat, and we believe that our culture empowers us to deliver on key market differentiators that are difficult to replicate.

We are open and transparent, and we zero in on execution not politics. Our solution-orientated mindset continuously focuses on better solving customer pain points.

We attract top talent that does not step away from a challenge, and is not afraid to try something new. People that believe in hard work, less frills and more action. It is not easy to take ownership of work, but for our entrepreneurial and customer centric teams this is a key result of the innovation and creativity they continuously demonstrate.

As with most things, talking is easy. But our teams lead by example. We have had team members work their way from in-field technicians to key decision makers, from analysts to leading country managers. Not only does this show our teams the progression and reward they can achieve in their career, but it also creates a team with a diverse set of experience, skills and knowledge that is able to empathise with the challenges faced by our diverse customers to solve them. We have a loyal team with the deep business and industry understanding required to build scalable tools that unleash the potential of operational businesses.

Our culture is not for everybody. But the people that fit our DNA are resourceful, ingenius and have a strong desire and ability to solve complex problems efficiently. They collaborate and combine their knowledge from diverse industries and geographies to deliver on easy-to-use solutions in a quick and efficient way. Our staff are motivated by the success we see in our customers and this places us in the privileged position of working with a team that has a long-term mindset that is designed to win.

I will now hand 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 Q2 FY24. Please note that all comparisons are against Q2 FY23 unless otherwise stated.

DECADE-PLUS STRONG TRACK RECORD
Our Q2 performance has gained momentum, building from our solid start of the year and demonstrating growth across various financial metrics.

As expected, after substantial investment for future growth, in Q2, Karooooo's total subscription revenue increased by 17% to ZAR 860 million.

Operating profit increased by 13% to ZAR 247 million and earnings per share increased 14% to ZAR 5.61.

Our profitable SaaS business model continues to bolster our cash flow generation ability, net cash from operating activities increased by 26% to ZAR 304 million. This healthy cash generation will continue to support our future cash outflows required for investment and future growth.

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.

After paying a dividend of USD 26.3 million and investing ZAR 87 million in the development of the South African Central Office, our net cash on hand stood at ZAR 651 million.

Debtor's turnover days improving to 29 days alongside with prudent provisioning to weather off strong economic headwinds in some of the markets we are operating in.

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 14% to ZAR 5.61. 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 beating the rule of 40.

Overall, subscribers grew at scale by 14% to over 1.83 million.

And in this quarter, subscription revenue grew 17% to ZAR 858 million while operating profit stood at ZAR 252 million.

CARTRACK STARTS TO GAIN MOMENTUM WITH RECORD Q2 NET SUBSCRIBER ADDITIONS

Our solid start in Q1 continued as we gained momentum in Q2 with a record net subscriber addition of over 75,000 in this quarter. This was largely supported by the increasing demand of small to large enterprises, emphasizing the necessity to enhance compliance functions and digitally transform their businesses to become more efficient and competitive.

CARTRACK CONTINUES WITH DECADE PLUS TRACK RECORD OF GROWTH

Cartrack continues to build on its solid track record of growing at scale and experienced strong customer acquisition in this quarter.

Cartrack's total subscription revenue grew 17% to ZAR 858 million and represents 97% of total revenue, which is in line with our SaaS business model.

Total revenue grew 17% to ZAR 884 million.

Our SaaS ARR grew 17% to ZAR 3,475 million.

Cartrack's operating profit grew 13% to ZAR 252 million and adjusted EBITDA grew 9% to ZAR 417 million.

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 159.

Cartrack's average lifetime revenue per subscriber in this quarter stood at ZAR 9,556.

The average up front cost of adding a subscriber to our cloud in this quarter was ZAR 2,293. 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 7,263.

From the ZAR 7,263, 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 14%.

In Asia, the Middle East and USA, subscribers grew by 26% as the traction in South East Asia has been encouraging. South East Asia remain as the second largest contributor to the group's revenue and we believe our value proposition will continue to find favor in this region and present the most compelling growth opportunity and deliver increasing and sustainable income to the group in medium to long term.

Europe saw a healthy growth of 14% 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. In addition, we are experiencing encouraging demand for our proprietary compliance technology in the region.

Africa-other maintained its growth with 8% increase in subscribers.

At the end of quarter 2, our ARR increased 17% to ZAR 3,475 million.

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

CARTRACK 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 72% which is consistent with our expectation.

Research and development expenses as a % of subscription revenue are 6% as we focused on driving substantial benefit from our R&D capital allocation. Our planned investment in improving, enriching and expanding our Operations Cloud and internal management system is to enhance our value proposition to our customers.

Sales & marketing expenses as a % of subscription revenue increase to 14%.

We believe the strategic investment for customer acquisition positions us well for continued growth and we expect to see future benefits from this investment.

General and admin expenses as a % of subscription revenue are at 22%. This planned increase reflects management's commitment to build a strong support infrastructure to meet our future growth plan.

Operating profit as a % of subscription revenue is 29% and our adjusted EBITDA as a % of subscription revenue is at 49%.

CARTRACK'S OUTLOOK FOR 2024

We have had a solid start and we are happy with the progress we have made in Q2.

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 delivered ZAR 85 million in revenue in this quarter and an operating loss of ZAR 13 million.

Subsequent to the Q2 end, despite the growth experienced by Carzuka in South Africa, a decision was made to cease buying second hand vehicles in South Africa. This decision follows considerable interaction with motor dealerships over the last 12 months.

Over the years, Cartrack has been partnering with dealerships as part of its customer acquisition strategy to acquire customers through the introduction of these dealerships.

However, some dealership has perceived the Carzuka's business interest to be conflicting within their business interest in buying vehicles from customers.

We maintain that the Carzuka business model is robust, but we do not want to risk the long-standing strategic relationships that Cartrack has forged with motor dealerships across South Africa.

Karooooo Logistics delivered significant growth generating ZAR 72 million in revenue and an encouraging operating profit of ZAR 8 million in this quarter.

Its focus on delivery-as-a-service ("DaaS") through selected third-party crowd sourced drivers and logistics companies has been highly scalable and is delivering substantial growth. 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.

We believe, the benefits of our strategic investment in this segment area beginning to show.

I would like to thank everybody for joining us today and we 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 the presentation.

Question: Myles Fourie

When will Cartrack start monetizing Data as a Service? What % of Cartrack's annual revenues will come from Data as a Service in say 3 years' time?

A – Zak Calisto

Data as a service is currently what we do.

We basically take raw data and push it through IoT devices into our Cloud. We then process the data and give intelligent business reports to our customers.

In our opinion, a great portion of our subscription revenue model is already data as a service which we offer as software as a service.

Question: Sebastiaan Kwakkenbos, Buffalo Thorn Capital Management

Can you expand further on the decision to shut down Carzuka in South Africa. Will there be any costs associated with closing this division? There will obviously be a small impact to revenue from closing the business but should we assume it is positive for operating profit?

A – Zak Calisto

We have one lease and it comes to closure during this financial year, so there are no real material costs. We have got in Cartrack now about 500 vacancies open, the majority of Carzuka staff we will transition into Cartrack. There are no major costs, clearly these costs could have a slight impact on Cartrack initially but that has been planned and it will be phased out. By the time we get to FY25, these costs will not be wearing us down. The reality is that we have had operating losses of approximately ZAR 50 million a year and we see this loss disappearing and it will reflect positively in our earnings next year. Although I do believe that had we spent enough effort to really put our shoulders behind Carzuka we would have been much further. But we have been in long discussions with our motor dealer partners and a few of them have said that we have a conflict of interest with them, and we have decided to save these long-standing relationships and to rather continue keeping our relationships with the motor dealers healthy.

Question: Matthew Hodgkinson, Confluence Impact Fund

Despite the growth experienced by Carzuka in South Africa, a decision was made to cease buying second hand vehicles in South Africa. What does this mean for Carzuka? Will you still be buying and selling vehicles in South Africa? But from a different source (i.e. only from dealers) or will you cease selling vehicles?

A – Zak Calisto

We have the platform and we have developed the software for Carzuka. We will still utilise the software for the benefit of our dealership partners. Currently, quite a lot of our dealership partners advertise their second-hand vehicles on the Carzuka platform and we then assist them in selling their pre-owned vehicles. We do not see this as conflicting, anyone wanting to advertise on our platform can do so, but we won't be taking any inventory in buying and selling second-hand vehicles. We will still allow our dealership partners to get the benefit they have reaped until now.

Question: Alex Sklar, Raymond James

Cartrack operating margin was up nicely this quarter, can you talk about operating margin expectations for 3Q/4Q given you are absorbing Carzuka employees?

A – Zak Calisto

It could certainly have a negative impact on Cartrack but it is really a planned impact that we would have done anyway because we need to employ the staff.

I don't think the impact is material, the staff moving over to Cartrack is strategic. We know the people, so we already know their strengths and weaknesses and where to put them and into which departments. It's all really helping us fill about 500 vacancies we have at the moment.

Question: Matthew Pfau, William Blair

Has the net subscriber momentum in the second quarter continued into the third quarter?

A – Zak Calisto

Yes it has. In the first 40 days of Q3 our net subscriber additions were actually 40 000, we are expecting to probably be over 80 0000 net subscribers during Q3. That is our expectation for Q3 given that we are halfway through Q3.

Question: Matthew Pfau, William Blair

Can you provide an update on the OEM relationships? When could these start to contribute to subscriber additions?

A – Zak Calisto

We have done a lot of integrations already with the European OEMS, we should be able to start seeing fruits from these relationships in FY25.

Question: Matthew Hodgkinson, Confluence Impact Fund

Please can you comment on the proposed merger between Mix Telematics and Powerfleet.

1) Which geographies do you overlap in?

2) What differentiates your offer from Mix & Powerfleet?

3) Do you focus on different customers or routes to market?

A – Zak Calisto

I must say I am not very familiar with Powerfleet, Mix I am relatively familiar with them. My understanding is that Powerfleet is American-based, but I prefer not to comment as I do not know. I haven't delved into this information.

If we compare ourselves to Mix, I do not believe we focus on different customers or different routes to market.

I think there's multiple vendors with our types of solutions, our route to market although at high level it looks similar but fundamentally when you get into the detail, we are quite different. Mix operates in about 100 geographies; we only operate in 23. We are a great believer that we need to have staff on the ground in all the countries, we do not distribute in countries where we do not have a physical presence. I think that makes quite a big difference. We are very focused on owning the customer, and that could also be a little bit of a difference between us and Mix potentially, but I am speaking under correction.

Question: Sandile Magagula, Umthombo Wealth

1) Cartrack EBITDA margin hit 47%, have we reached the bottom at this level, can you allow margin to trend below the 47% mark?
2) Secondly, in terms of SA subscriber growth, at which level do you expect growth rates in subscribers to peak given +13% growth achieved in Q2?
3) Thirdly, the plan is to integrate Carzuka staff in Cartrack. What is the estimate impact of this introduction at Cartrack?
4) Fourth question, where do you see Cartrack return on common equity peaking over the coming years?
5) You're certainly making better returns for us than handing over your earnings in form of dividends, at what phase of the growth cycle of the business it would make sense for you to buffer us with dividends given the naturally high cash conversion rates, especially when investment in organic growth hit the peak?

A – Zak Calisto

1) We've traditionally had our EBITDA margins between about 44-45 and 52%, we believe that will continue. It depends how much capital we've allocated into back-office and to sales and it's a timing thing. We envisage that we will remain within these margins for quite a few years to come.
2) South Africa we have about 1.4 million vehicles on our cloud, we believe we can drive that to about 3 million vehicles. We will try do that as quickly as possible. Currently, we starting to see better momentum in growth in Q2 compared to Q1 and in Q3 we continue with that momentum.
3) Carzuka staff question, we have covered that.
4) We have a lot of cash, if it is given out as a dividend then you will be in a situation where the return on equity spikes.
5) Pragmatic in the way we run the business. We've got sufficient cash to accelerate growth and we intend keeping a solid cash base on our balance sheet like we've been doing. We're generating quite a lot of free cash flow and at this point we can't deploy as much cash as we're generating.

Question: Myles Fourie

Why does Karooooo regard SE Asia as the Group's most compelling growth opportunity in the medium to long term when it has the same TAM as Europe and Cartrack have partnered with leading OEMs in Europe?

A – Zak Calisto

We believe SE Asia is the largest in terms of the economy growth, it is probably one of the fastest growing economies in the world. It is also a huge and large addressable market. We've come in as outsiders and we are making good progress, starting to get good momentum. We still have a very long way to go before we reach the full TAM.

Have answered OEM question.

Question: Myles Fourie

Historically, Cartrack have doubled their number of subscribers every 4 years. Do you see this continuing at this pace or at a faster pace given the recent growth in both SE Asia and Europe?

A – Zak Calisto

Currently we're growing slightly slower than we did in those years, when Covid came and then the one-year post-Covid it did sort of cramp our style but we are getting momentum. Our intention is to grow to more than double our subscriber base in less than four years. It is just a question of us getting our momentum back, which we certainly are getting post-Covid.

Question: Alexander Sklar, Raymond James

Can you talk about the linearity of subscriber gross from June through September? Did you see improvements every month or was it fairly-ratable?

Any change in vehicles per customer in terms of what you added this quarter?

A – Zak Calisto

Our customer base in terms of SMES, large enterprise customers and consumers remains quite constant over the years. Our growth has been quite consistent daily. We really measure our growth on working days. We have very steady growth; we measure it on a daily basis. The more working days we have, the better we do. And we certainly are picking up momentum.

Typically, our Q3 is our best quarter as there are less holidays in Q3.

Question: Suhail Salman

What will be financial impact of ceasing Carzuka in South Africa? What % is coming from refurbishing.

A – Zak Calisto

Have answered this question.

Question: Andrew Ing

Do you compete with Descarte Group for the same customers?

A – Zak Calisto

Apologies, I do not know the Descarte Group.

Question: Chris Logan, Opportune Investments

Well done on strengthening momentum, Samsara is seeing a lot of strength in non-vehicle applications. What they call equipment monitoring. Is this an area you see serious potential in?

A – Zak Calisto

Fundamentally, there's a lot of demand from our customers for IoT devices for equipment. So it depends what you call equipment, but we have a lot of yellow machinery and forklifts on our base. We deal with a lot of machinery already, so when we say subscribers some of it includes that type of equipment that has been used in warehouses. As long as it has an IoT device, and we can collect raw data and push that data into our cloud and help our customers run their businesses. That's what we do.

Question: Sikonathi Mantshantsha, News24

Carzuka will be closing down altogether?

A – Zak Calisto

We have got the technology, so the company will remain open. The company will not be buying and selling vehicles or owning inventory.

Question: Hristo Georgiev

ARPU has been stable for quite some time. Given all the inflation around the world, what is the reason you haven't increased prices?

A – Zak Calisto

Our ARPU today is the same that it was 15 years ago and we have great operating profit margins, EBITDA margins and gross profit margins. We continue to grow our customer base. Quite frankly, the best way we've managed to beat inflation is through economies of scale. As we field these expenses, clearly we field them over the years but we've always been able to beat inflation through economies of scale.

END

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