Transcription

Q2 2023 Financial Results of Karooooo.

Karooooo Ltd (NASDAQ:KARO) Q2 2023 Earnings Conference Call October 13, 2022 8:00 AM ET

Company Participants

Zak Calisto - Founder, CEO & Director

Richard Schubert – Group Chief Operating Officer

Carmen Calisto – Group Chief Strategy and Marketing Officer

Conference Call Participants

Richard Schubert

Good Day. I would like to welcome everyone to the Karooooo Quarter 2 FY '2023 earnings presentation.

I'm Richard Schubert, the Group Chief Operating Officer and will present our current operating strategy while Carmen Calisto, our Chief Strategy and Marketing Officer, will present the financial results. The Group CEO and founder Zak Calisto will then answer any questions.

Karooooo Management would like to advise all investors to review this disclaimer.

Karooooo, which is listed on the NASDAQ under the ticker KARO, has three operational entities that we will review – Carzuka, Cartrack and Karooooo Logistics.

We are thinking beyond connected vehicles and equipment as mobility is core for all on-the-ground applications. Our mission is to establish the leading on-the-ground operations cloud platform.

We solve problems by digitally transforming businesses. Our fleet management platform manages safety and visibility operations for our customers. Field worker management is helping SMEs like plumbers and ground servicing companies deliver. Logistics and delivery platforms are helping pharmacies and supermarkets with their on-time supply chain operations, while Carzuka is providing a safe and easy-to-use vehicle buying and selling platform. We are seeing a growing demand from small and large businesses to add operational efficiencies to their organization.

Karooooo investment highlights that drive shareholder value
We are at the early stage of a large and growing addressable market where mobility with IoT is key to improving operational efficiencies. Our decade long track record shows strong customer acquisition even in challenging markets with a robust and consistent business model.

With large expansion options across 23 countries by tapping into the untapped network effect, we have a long-term track record with a robust balance sheet and revenue generation with disciplined capital allocation and a strong cash position despite allocating cash for future growth. Our track record has positioned us well for accelerated growth, with strong operating profits and unit economics while our founder-led culture focuses on agile innovation.

We are at the early stage of a large and long-term growth opportunity. We strongly believe that mobility is core to all on-the-ground operational improvements, which represent over 40% of the global GDP. Within South Africa more than one in 10 vehicles are connected to the Karooooo platform, while the focus in Asia and Europe is to grow and deliver more operational value to our customers. There are many opportunities for us that are ripe for us to disrupt at this point in time. We are able to analyze our data to understand what our customers need, and are adding many verticals to our platform to capitalize on our network effect and continue to add growing value to our customers' operations.

Karooooo wins by providing a fully inclusive end-to-end IOT cloud platform that is easy to use for our over 95 000 customers.

It's continually updated and seamlessly integrates with customers third party ERP solutions. Our expanding distribution network ensures we service customers within the shortest possible lead times.

We understand our customers day-to-day challenges and our on-the-ground platform solves these issues and gives them a high ROI. Our fully vertically integrated business model means we might have a slightly larger staff count, but provides a full control of all aspects of the business. Our established infrastructure gives us the human resources to scale with a proven track record to achieve strong growth. Karooooo is an agile and entrepreneurial culture that has proven to be resilient in challenging times. I will now hand over to Carmen to present our Q2 financial numbers.

Carmen Calisto

Thank you Richard. I will now talk through Karoooo's financial performance for Q2 FY23. Please note that all comparisons are against Q2 FY22 unless otherwise stated.

Q2 proved to be strong in terms of our financial metrics with record earnings and cash generation. Our earnings per share increased by 28% to ZAR 4.93 and our profit for the period was up 26% at ZAR 155 million. We continued to generate healthy amounts of cash from operating activities and our free cash flow hit an all-time high of ZAR 1 billion. Our performance, despite economic headwinds, acts as testament to our resilient business model that is highly cash generative.

Supported by a high customer retention rate, Karooooo continues to grow at scale with a 30% increase in revenue and 26% increase in profit. Our strong, sustainable revenue growth resulted in a 27% increase in adjusted EBITDA to ZAR 377 million. We have strong unit economics, robust operating margins, a strong balance sheet and cash position, and have consistently beaten the rule of 40.

In spite of our investment for sustainable growth, net cash on hand has increased to over ZAR 1 billion. Naturally, this has been supported by the improvement in Cartrack's debtor's days to 33, which was a direct result of our constant strategic investment in internal systems that ensure our strong track record remains consistent as we continue to scale.

We have a strong, clean balance sheet with ample capacity to fund growth. Our cash generated from operating activities increased by 42% to ZAR 240 million, we invested ZAR 134 million in PPE and our free cash flow is ZAR 106 million - up over 100%. We have strong revenue generation, earnings growth as well as cash flow, putting us in a unique position in the market.

We will continue to allocate capital to acquire more customers and are focused on increasing Karooooo's presence across geographies and industries. As you can see, many other world-leading large enterprise customers rely on our solution to overcome their operational challenges.

Our differentiated culture, easy-to-use platform, great value proposition and strong customer centricity continue to pioneer success amongst businesses of all sizes across varied industries and geographies. Our customer portfolio remains agnostic, with no significant customer or industry concentration risk.

Due to the nature of each business segment, we are reporting our performance broken up by Cartrack, Carzuka and Karooooo Logistics. Our total revenue has increased by 30% and sat at ZAR 859 million at the end of Q2.

Cartrack grew its revenue by 16% to ZAR 753 million and operating profit by 24% to ZAR 223 million. Our adjusted EBITDA grew by 27% and our adjusted EBITDA margin is over 50%, in keeping with our outlook for FY23.

Carzuka's revenue grew from ZAR 9 million to ZAR 65 million and we are seeing improving traction as a result of improved brand presence despite temporary delays in some of our expansion initiatives. Our operating profits remain negative at ZAR 6 million, and our adjusted EBITDA also negative at just under ZAR 6 million.

Karoooo Logistics continued to gain momentum through customers acquired since joining Karooooo. Revenue now sits at ZAR 41 million, as compared to ZAR 28 million at the end of Q1 of this financial year. Our operating profit and adjusted EBITDA at the end of Q2 were both just under ZAR 1 million, and we believe we are on track to becoming profitable.

All segments are seeing strong traction, with the benefits of our strategic investments beginning to show. We will continue to build our businesses, Cartrack, Carzuka and Karooooo Logistics.

We will now focus on Cartrack, the underlying asset to Karoooo's success and ability to drive positive impact by maximising the value of data.

Cartrack continues to have great visibility of future revenue, with subscription revenue as a % of total revenue increasing from just below 97% to over 97%. Subscription revenue grew 17% to ZAR 733 million and total revenue grew to ZAR 753 million as compared to ZAR 650 million last year.

Our track record of execution extends over a decade and we have a proven ability to scale in varying market conditions. Total subscribers grew to over 1.6 million and our subscription revenue grew to a strong ZAR 733 million despite challenging operating environments. Our realisation of economies of scale and increased staff productivity favourably offset investment and our profit after tax grew 29% to ZAR 163 million.

We saw record net subscriber additions of over 57,000 this quarter as compared to other Q2s to date. This was largely supported by demand of small to large enterprises looking to increase their efficiencies and future-proof their businesses by digitalising their day-to-day operations.

Cartrack continued to expand in all geographies. Despite challenging environments in South Africa due to power outages, subscribers grew by 12%. Asia, the Middle East and USA grew by 25%, with strong demand coming from South East Asian markets in particular where we are seeing increased brand recognition and a stronger appetite for our leading value proposition as more businesses look to digitalise their operations. Europe saw a healthy growth of 16% and remains a region we aim to allocate more resources to in order to drive more rapid growth. Africa other maintained its momentum with a 10% increase in subscribers.

Cartrack's low cost of acquiring a customer, high customer lifetime value and retention rate as well as strong comparative benefits from economies of scale result in attractive unit economics. Our Lifetime Value (LTV) to CAC is over 9 and we have strong profit margins; our gross profit margin on subscription revenue is 75% and our operating profit margin is 30%. Whilst we will remain prudent with our capital allocation, we are well positioned to materially increase investment for growth.

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. Research and development as a % of subscription revenue remains at 6%, in line with our long-term targets of 4-6%. We will be increasing capital allocation into sales and marketing to drive growth, whereby we expect sales and marketing as a % of subscription revenue to increase from the current 14% to be within our long-term target of 17-19%. We also expect general and admin as a % of subscription revenue to drop from 23% as we experience increased economies of scale, whereby it will fall in line with targets of 12-16%.

Our adjusted EBITDA as a % of subscription revenue is in line with our targets of 50-55% at its current 52%.

We are happy with the progress we have made in Q2 and Cartrack's outlook for 2023 remains unchanged - number of subscribers is between 1.7 and 1.9 million, Cartrack's subscription revenue is between ZAR 2.95 and ZAR 3.1 billion and Cartrack's adjusted EBITDA margin between 45 and 50%.

Carzuka and Karooooo Logistics showed good progress with strong quarter on quarter growth of 31% and 49% respectively. We feel very positive about the direction of these businesses and are continuing to leverage Cartrack's data and analytical capabilities to pioneer innovation within both of them.

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 Zak Calisto.

Question-and-Answer Session

Zak Calisto

Good afternoon from Johannesburg.

Question: Alex Sklar, Raymond James

Really nice customer growth of over 95 0000 commercial customers. Can you talk about how you have positioned yourselves and operations to move up market? Is there any commonality in where you are having success with these enterprise customers?

A – Zak Calisto

Post-Covid, which is approximately now 4/5 months depending on which geography we're talking about, we are actively recruiting people to tackle the large enterprise customers.

We believe we will get momentum from Q4 this year.

We understand that the cycle to onboard large enterprise customers is longer than SME customers, but we will get momentum in about three quarters from now given the lead times with these customers and given the fact that they are probably in a contract with one of our competitors at this time.

Question: Alex Sklar, Raymond James

Can you provide some colour on how subscriber growth has trended in September/October, any changes on buying behaviour in the current macro?

A – Zak Calisto

September has been our best month ever in net subscriber additions, we've never had a month of 24 000 net subscribers. So Q3 is looking good judging by September. And if we look at half way through October, we're quite content with the way it is progressing.

Clearly, we still have a long way to go in terms of recruiting people and building our teams to be able to execute on our plans to accelerate our growth.

Question: Willow Miller, William Blair

Any changes in customer retention given the softer macro environment?

A – Zak Calisto

There has definitely been a change, but I would call it insignificant and I would call it non-material at this stage.

Question: Willow Miller, William Blair

What was the primary driver of Cartrack's adjusted EBITDA margin expansion from 49% last quarter to 51% this quarter?

A – Zak Calisto

I think a lot of it has to do with us just retaining costs and watching specifically our gross profit margin. We've negotiated better rates with some of the suppliers and its really about just optimising the cost structure.

Question: Willow Miller, William Blair

Could the recent COVID restrictions and lockdowns in China have an impact on the traction in Asia?

A – Zak Calisto

It could, but I doubt it. I think the whole world is over Covid and I don't see any restrictions coming into South East Asia.

Question: Goku Raj

An you speak about your competitive position in South Africa and also if the margins are similar to South Africa.

A – Zak Calisto

At the moment our region that has the best margins is clearly South Africa purely from an economies of scale perspective, but we see that South East Asia will have very similar unit economics to South Africa specifically once we are at scale. In terms of the competitive landscape, we came to the market approximately 10 years after all our competitors and at this point in time we are the largest and certainly fastest growing in the industry.

I also believe we have the most diversified customer base in terms of size of customers and industries. I think we are well positioned to continue to compete favourably with our competitors. Having said that, I do believe our are sophisticated and we cannot rest on our laurels.

Question: Matthew Kikkert, Stifel

Do you expect continued traction and execution in Southeast Asia will be the biggest growth driver over the remainder of the year, or could we see another region like Europe achieve an equal or greater subscriber growth?

A – Zak Calisto

The reality is that the months go by very quickly, and we're very busy with recruitment and re-adjusting the way we go to market with our plans for accelerated growth.

The onboarding and training of people is quite difficult in a short period of time and to second-guess what will work best.

I believe in FY24 we will start getting real momentum and reaping fruits of what we're doing today and I firmly believe that South East Asia will be our fastest growing region.

Question: Khanh Ho

Could you please explain about the increase of almost 3 times in trade payable of this quarter vs. last year? Will this level be sustained?

A – Zak Calisto

Not sure where you are seeing that, but happy to look into it and provide response. I don't see how our debtors has tripled. Please email me so I can look into it and respond.

Question: Matthew Kikkert, Stifel

Have economic and labour pressure increased the importance and value of your product set in the eyes of potential customers? How often are these factors the leading reasons for adoption of your Operations Cloud?

A – Zak Calisto

We have many factors that drive demand for our Cloud, clearly one is operational costs that can include salaries and other relative operational costs.

I don't think there is any specific thing that drives that. It could just be the efficiencies, cost saving and customer service that our customers derive from adopting our Cloud. Our value proposition is really what drives our customer demand and there's many aspects not just labour pressure.

Many companies even prior to the headwinds they're facing have always looked to how they can digitalise operations in order to have less staff and achieve more visibility and reliable information about their businesses.

Question: Patrick Cadel

What drove the big pickup in Karooooo Logistics revenue?

A – Zak Calisto

It's all organic growth as we onboard customers, and we are expecting Q3 to be much stronger than Q2. All is going according to plan, and we foresee that Q3 will be substantially stronger than Q2.

In terms of profitability of the business, Q2 was really marginally profitable but we believe that the business will have approximately 5-7% revenue that will be operating profit once we reach scale.

Question: Drikus Greyling

How does the competitive environment in Europe and Asia compare to one another?

A – Zak Calisto

Asia is more similar to South Africa in terms of environment.

In Europe, the type of customers we are dealing with on a commercial front is slightly different.

We have no real significant competitor in Asia at this point in time, and believe we can compete there favourably.

Europe has a more consolidated market with five strong competitors, which is very similar to South Africa and we believe we can compete favourable there.

Question: Rendani Magalela

How far are you with the plans to improve liquidity of the shares?

A – Zak Calisto

At this point in time, only way we can do that is by issuing shares.

We have no reason to issue shares given that we have ZAR 1 billion in our bank account and no acquisition in mind. Should we have an acquisition in mind or need cash, we believe the Nasdaq places us well and we have a great financial platform to raise capital.

The other option is selling down of shares, which we will look at over the next five years. I will sell my shares to give liquidity to the market in a disciplined way over five years and it won't be one single tranche.

I have to focus on growing the business and the free float will be worth more. Currently, prices are under pressure in the market and all we can do is focus on the business and underlying asset.

Question: Viwe Kupiso, Prescient

What has been the impact of loadshedding on Karooooo operations in SA? How has Karooooo dealt with the challenge of loadshedding?

A – Zak Calisto

Clearly loadshedding has affected the South African economy, we've got generators to keep us operational but some of our customers might not have.

Also, we rely heavily on the infrastructure of communications, and that has been under pressure.

We haven't been an island, and we have had to live within these headwinds caused by loadshedding.

Question: Marc

What revenue target have you set for Carzuka in the next five years? When do you anticipate break even? And what would you be hoping for in terms of sustainable margin?

A – Zak Calisto

We are in the process of ironing out teething problems. We have a target of ZAR 300 million per quarter in revenue. We'll be in a position to plan the next three, four to five years once we iron out all these start-up operational issues.

To break even, we could do that tomorrow if we decide not to grow. When do you expect to be at scale, when we reach ZAR 300 million per quarter we can plan on how to go to ZAR 300 billion per quarter.

We have always grown organically and we want to continue with that same mindset.

We have been operating with very low margins, and a sustainable margin will be around 4-6% operating profit once at scale.

Question: Myles Fourie

What impact is inflation, strong USD dollar and supply chain dynamics having on the Cartrack business?

A – Zak Calisto

Clearly with the Rand under pressure, that also puts our business under pressure. If we had not had the Dollar negativity in Q2, our results would have been better. But our operating margins are able to weather the storm. We know that the Rand overreacts, it either over weakens or over strengthens and it does come back in time. We have sufficient operating margins to weather the storm.

Question: Sandile Magagula

Given high inflation in Europe, what sort of return on capex are you looking to achieve? Given planned capex ramp up in both Europe and Asia, can you please kindly provide insight on whether we can expect Adjusted EBITDA margin at the high end or bottom end of the guidance range? In Africa, what explains the huge dispersion between subscriber growth and subscription revenue growth?

A – Zak Calisto

We've given 45-50%, I'm personally expecting closer to 50% EBITDA margin for this year but we are maintaining the 45-50% outlook.

Return on capex might weaken because of costs but will be insignificant and materially in line with historical numbers.

During Covid we had a lot of non-billing customers that we stopped billing and a lot of those customers have resumed billing again and we have a spike in subscription revenue. This was about 23% and where our subscription revenue only went up by 10%.

Question: Khanh Ho

Could you please provide more color on the operations/ performance of carzuka? Whats the average ticket on carzuka? Are there any value-added steps (like replace old car parts, repaint,…) when you sell car to buyers?

A – Zak Calisto

We have a tremendous amount of data from our customers and it gives us good visibility of vehicles and how the vehicle is being driven. This allows us to price the vehicles whereby our customers get a good price for their cars and gives us a small margin to be able to onboard and sell the vehicle to the next customer.

We operate with low margins, between 12 to 15%. It's a volume game, and is not about making a lot of profit out of one specific vehicle.

Our average vehicle costs about ZAR 100 000 and we're in the early stage of this operation and as it gains traction and we iron out teething problems, there will certainly be an opportunity to sell value adds which we're currently at this stage not doing.

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