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PRESENTATION

Operator

Welcome to CalAmp's Second Quarter 2023 Financial Results Conference Call. My name is Tamia, and I will be your moderator for today. (Operator Instructions)

As a reminder, this call is being recorded. I would now like to introduce your host for today's conference call, Joel Achramowicz, Managing Director of Shelton Group, CalAmp's Investor Relations firm. Joel, you may begin.

Joel William Achramowicz - *Shelton Group - MD of IR*

Good afternoon, and welcome to CalAmp's Fiscal Second Quarter 2023 Financial Results Conference Call. I'm Joel Achramowicz, Managing Director of Shelton Group, CalAmp's Investor Relations firm. With us today are CalAmp's President and Chief Executive Officer, Jeff Gardner; CFO, Kurt Binder; and also Cindy Yang, Senior Vice President of Financial Planning and Analysis.

Before we begin, I'd like to remind you that this call may contain forward-looking statements. While these forward-looking statements reflect CalAmp's best current judgment, they are subject to risks and uncertainties that could cause actual results to differ materially from those implied by these forward-looking projections.

These risk factors are discussed in our regular SEC filings and in the earnings release issued today, which are available on our website. We undertake no obligation to revise or update any forward-looking statements to reflect future events or circumstances.

Now Jeff will begin today's call with a review of the company's operational highlights. Then Kurt will provide a more detailed review of the financial results, followed by a question-and-answer session.

With that, it's my great pleasure to turn the call over to CalAmp's President and CEO, Jeff Gardner. Jeff, please go ahead.

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Thank you, Joel, and thanks to all of you for joining us on the call today. Our second quarter results exceeded our expectations, reflecting approximately 13% sequential growth in consolidated revenue, driven primarily by Software and Subscription Services revenue growth that was also up 13% sequentially and 7% year-over-year.

Software and Subscription Services revenue represented 61% of total revenue. This revenue growth resulted from improvements in the supply chain that allowed us to accelerate customer conversions to recurring software contracts and also to fulfill more orders for our telematics product customers than the prior quarter. As of today, more than 50% of our eligible customers have converted, including recent transitions by notable customers, Localiza and Trimble, among others.

We continue to gain traction in all geographies with total global subscribers increasing 9% sequentially and 32% year-over-year to $1.3 million at the end of the second quarter. We gained strong traction in the EMEA region from recent conversions, along with new logos, including BMW's Mini and Wabi/Santander. Additionally, along with North America SaaS conversions, we also added new subscribers from existing software customers such as the City of Dallas, which signed a contract extension with us during the quarter.

We remain on track to complete most of our eligible customer conversions to subscription contracts by the end of the current fiscal year, as we have stated in the past.

Brennen Carson, was appointed as CRO in June has been working hard not only to advance these conversions, but also to expand opportunities with existing subscription customers and to secure new logos.

Also during the quarter, as we broaden and deepen our overall solutions offerings, we made great strides in the areas of our Smart Trailer and Video-Based safety solution offerings.

CalAmp's smart trailer technology empowers transportation operators to improve fleet performance, maximize asset utilization and comply with regulations, thereby transforming the way these businesses operate. Together with our Video-Based Safety solution, our transportation and logistics customers can also use video technology to train, assess, monitor and document asset operation in real time to improve safety, reduce cost and increase on-time performance.

With roughly 90 million commercial fleet vehicles and 35 million heavy trucks in operation around the world today, these 2 CalAmp technology initiatives will not only help us expand our opportunities and customer base but also strengthen our current customer relationships by offering new best-in-class tools to help them gain even more from their telematics investments.

We completed a major update of our corporate website and branding, including more expanded information on our telematics solutions such as video webinars and testimonials, product brochures and other valuable resources for prospects, customers, investors and the press. Visits to our website have increased 30% since we deployed the upgrade.

As you know, Kurt's last day will be tomorrow, and thereby, this will be his last earnings call with us. I want to thank him for his support and years of service as our CFO and wish him the best in his new endeavor. In terms of an update on our CFO search, we have been working with a leading executive search firm over the past several weeks. As mentioned in our press release, Cindy Yang, our current Senior VP of Financial Planning and Analysis, who has been with the company since 2017, will serve as interim CFO, effective tomorrow until a successor is named. She and her finance team are fully qualified to maintain the integrity and consistency of our financial operations under my close oversight.

With that, I'd like to now turn the call over to Kurt to discuss our financial results in more detail. Kurt?

Kurtis Joseph Binder - *CalAmp Corp. - Executive VP, CFO & Principal Accounting Officer*

Thank you, Jeff. I appreciate your kind words and the time that I had to work with you and the entire CalAmp team. I believe the company is well positioned to continue its growth and transformation to a leading telematics SaaS-based competitor.

With that, let's dive into the second quarter numbers. Today, my commentary will include reference to the non-GAAP financial measures of adjusted basis net income, adjusted EBITDA and adjusted EBITDA margin. A full reconciliation of these non-GAAP measures with the closest corresponding GAAP basis measures is included in the press release announcing our fiscal year 2023 second quarter earnings that was issued this afternoon.

Total revenue in the second quarter was $72.8 million, up approximately 13% from $64.7 million in the prior quarter though down approximately 8% from $79 million in the same quarter a year ago. The sequential increase in revenue was mainly attributable to the availability of product to support the acceleration of customer conversions to recurring subscription contracts as well as the fulfillment of customer demand for our Telematics Products.

International revenue in the quarter totaled $26.6 million or 37% of total revenues. Software and Subscription Services revenue was up approximately 13% sequentially and 7% from the prior year quarter to $44.5 million, representing 61% of consolidated revenue. It's instructive to mention that approximately $7.5 million of revenues in the prior year period was associated with 3G to 4G equipment upgrades for a large customer, which did not recur in the current year.

Both the sequential and year-over-year growth in our Software and Subscription Services business reflects the progress we're making converting eligible telematics device customers to recurring subscription contracts. As of the end of the second quarter, we've converted just over 50% of our total eligible telematics device customers and expect to convert the remaining customers by the end of our fiscal year.

In terms of performance metrics for our Software and Subscription Services business, Remaining Performance Obligations in the second quarter was approximately $210 million, a decline of 2% compared to $215 million in the prior quarter, but up 54% from $136 million in the same quarter a year ago. We expect to recognize over 27% or approximately $57 million of the performance obligations during the remainder of this fiscal year. During the quarter, our subscriber base increased 9% sequentially and 32% year-over-year to 1.3 million.

Telematics Products revenue in the second quarter was $28.3 million, which represented a 13% increase sequentially and a 25% decrease year-over-year. Within the Telematics Products reporting segment, OEM products revenue totaled $13.7 million in the second quarter compared to $10.5 million in the prior quarter, and $15.9 million in the same quarter a year ago.

Our largest customer represented $12.4 million of revenue for the quarter, which was up from $9.7 million last quarter, but down from $14.0 million in the same quarter a year ago. Our backlog with this customer remains solid.

Consolidated gross margin in the second quarter was 39.8% compared to 39.6% last quarter and 42.2% in the same quarter a year ago. Contributing to the high gross margin in the prior year was an increase in revenue from one of our largest customers associated with the 3G to 4G upgrade cycle. Gross margin continues to be under pressure due to increasing product and logistics costs that have yet to be fully offset by the price increases we've implemented to date. We expect gross margin to improve slightly over the remainder of this fiscal year as a result of increased revenues and to a lesser extent, favorable product mix.

Second quarter non-GAAP operating expenses on an absolute dollar basis increased by 3% sequentially, primarily due to increased compensation costs resulting from changes in the composition of our sales force to drive sales to our -- for our telematics subscription services.

Second quarter non-GAAP operating expenses on an absolute dollar basis decreased by 5% over the prior year, driven principally by a decrease in general administrative expenses, our focus remains on reducing G&A expenses in the quarters ahead.

Adjusted EBITDA in the second quarter was $4.8 million with an adjusted EBITDA margin of 7% compared to $1.9 million and a margin of 3% in the prior quarter and $8.3 million or 11% in the same quarter last year. The sequential increase in adjusted EBITDA in the second quarter was attributable to higher revenue in the quarter.

In terms of our overall liquidity position, at the end of the second quarter, we had total cash and cash equivalents of approximately $48 million as compared to $59 million last quarter. The sequential decline in total cash and cash equivalents is attributable to a reduction in free cash flows due to the payment of the settlement for the Omega legal matter discussed last quarter as well as lower revenue levels resulting from some supply constraints coupled with consistent operating expenses and an increase in deferred billings (or unbilled receivables). The deferred billings are a result of the conversion of one half of our eligible telematics device customers to multi-year subscription arrangements. The provision of services under multiyear subscription arrangements extends the cash conversion cycle due to upfront cash outlays for devices combined with deferred billing over the subscription period.

During the quarter, we executed a new $50 million asset-based revolving line of credit with PNC Bank to give us added flexibility as it relates to working capital. At August 31, there were no borrowings outstanding under this facility and the total borrowing capacity based on eligible accounts receivable and inventory was $34 million.

Additionally, we were in compliance with our covenants under this revolving credit facility. And we believe that our current cash and cash equivalents, coupled with the availability on our revolving line of credit, provide adequate liquidity to support our transformation and growth over the next 12 months. Our aggregate outstanding debt is approximately $232 million, including $230 million of the 2% convertible senior notes due August 2025. It should be noted that we are always evaluating ways to optimize our capital structure.

In reference to our outlook for the third quarter of 2023, the Company is maintaining its policy of not providing quarterly guidance as visibility into product shipments remains difficult to accurately assess. However, we do expect to achieve low to mid-single-digit percentage sequential revenue growth in the third quarter.

With that, I'll turn the call back over to Jeff to provide some final comments before we open the call up for your questions. Jeff?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Thank you, Kurt. In summary, the CalAmp team achieved a solid quarter with revenue growing sequentially from an increasing rate of SaaS conversions fueled by incremental device inventory and resulting in a major increase in total global subscribers.

With that, we will now open the call to your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Mike Walkley with Canaccord.

Thomas Michael Walkley - *Canaccord Genuity Corp., Research Division - MD & Senior Equity Analyst*

Great. Well, Kurt, best wishes. It's great to work with you all these years. Best wishes to you on your new opportunity. And Jeff, congratulations on the conversion looking strong across that 50% mark. Can you update us on just the supply chain improvements that helped in the quarter? And how does supply look to support the conversions in future quarters?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Yes. We were pleased. We saw some modest improvement, Mike, in the quarter that helped us in terms of, one, driving better revenue which you saw and assisting us with the conversions, which was equally important. We're able to grow software and subscription services as well.

We're not totally out of the woods yet, but I do see progressive improvement throughout the back half of the year, and we're still working very hard on that in terms of doing everything we can. We've made a few redesigns in terms of our products that make us more -- give us better clarity in terms of future-looking BOM improvement and we are looking to see, as I said, steady improvement in the back half of the year.

Thomas Michael Walkley - *Canaccord Genuity Corp., Research Division - MD & Senior Equity Analyst*

Okay. Good. Any update? I know you had a record backlog over $60 million, not too long ago. Is that coming down now as you're working through that backlog? Or is it still kind of similar levels?

Kurtis Joseph Binder - *CalAmp Corp. - Executive VP, CFO & Principal Accounting Officer*

Yes. Mike, it's still pretty high, but it has come down a little bit. So we're still pretty pleased at the robust nature of the demand. Obviously, we're hoping that, that continues in the second half of the year. And as we ship on that backlog, we have constant inflow of orders. So we're pleased with the progress we've made with the supply chain, as Jeff had mentioned, and the backlog has come down a little bit, but still pretty robust.

Thomas Michael Walkley - *Canaccord Genuity Corp., Research Division - MD & Senior Equity Analyst*

Great. Last question for me, and I'll pass the line. Kurt, I know you indicated gross margins would slightly improve over the next couple of quarters. But now that your transition is going well, you're over halfway through it. Once the costs improve on the hardware side and the price increases go through? Any thoughts just longer term where gross margins can trend from current levels?

Kurtis Joseph Binder - *CalAmp Corp. - Executive VP, CFO & Principal Accounting Officer*

So yes, as Mike we've discussed in the past, I mean, the great thing about this business model is that as we expand on that installed base, and that installed base becomes monetizable, that increased revenue base helps us with expanding our gross margins. So we're super excited about proceeding this fiscal year through the conversions, getting close to 70% of all of our customers over to the subscription model, that will be a major accomplishment.

Once that's done and things stabilize in the supply chain, and that installed base starts to monetize, it will have a pretty meaningful impact on our gross margin. As we've indicated before, our medium- to long-term financial model suggests that we target 50% gross margin. So that's still our goal across the entire enterprise.

Operator

The next question comes from Jerry Revich with Goldman Sachs.

Adam Samuel Bubes - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

This is Adam Bubes on for Jerry Revich today. You talked about expectations to achieve low to mid-single-digit sequential revenue growth in the third quarter. Can you just help us parse that out between the 2 segments?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Well, I think, Adam, we'll continue to see growth led by our software and subscription services revenue that's been performing well all along. We expect to do more conversions. If you've looked at our conversion numbers for the quarter, we're actually a little ahead of where I thought we would be. And so I think we'll continue at that pace. When we look at -- the fact that we've gotten a lot of our big customers over the finish line there, we're going to be very specific in terms of driving additional conversions in the third quarter.

And again, as we get through the customer base, which to me is really exciting, our sales force is going to continue to turn more towards new logos, which will help us grow across the base. And in particular, all of our new sales will be focused on software and subscription services.

Adam Samuel Bubes - *Goldman Sachs Group, Inc., Research Division - Research Analyst*

Great. And then in telematics, what was EBITDA margin in this quarter? And what does the path to profitability look like from here?

Kurtis Joseph Binder - *CalAmp Corp. - Executive VP, CFO & Principal Accounting Officer*

Right. So Adam, in the 10-Q that we filed this afternoon, we did lay out for you EBITDA margin by reportable segment. So you can reference that in that filed document. But to answer your question, we -- it's a bit of a journey here. Obviously, the first part of the journey we've been focused on is moving those telematics customers over to a subscription model as they evolve or move over to the software and subscription services business. The gross margin and EBITDA margin associated with that roll over to that reportable segment.

So right now, the EBITDA margin is actually negative for the Telematics Products reporting segment. Over time, as we finalize the conversion and we focus on essentially the customers within our OEM segment. We believe that, that reportable segment can be profitable or EBITDA positive, but it's going to take a little bit of time, and it certainly will take probably the balance of this year to even that all out.

Operator

Our next question comes from Mike Latimore with Northland Capital Markets.

Michael James Latimore - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Great. So I just wanted to be clear on the conversions. So I heard that you had finished the conversion by, I think, year-end, and I also heard maybe you get to 70% converted. Can you just clarify which one's accurate?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Yes. Yes, just I think there's a little confusion. We think that ultimately, our software and subscription services as a percent of revenue will increase to 70%, Mike. But we think that by the end of the year, we believe we'll get to 100% of our base converted to a subscription model.

Michael James Latimore - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Got it. And then for those conversions through year-end, what kind of ARR does that represent or what revenue level would that represent in terms of software and subscription?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Yes. As you know, we reported that we're about 50% through our customer base today. We're not providing guidance in terms of what the ARR for the remaining customers are. Obviously, we've got a couple of -- it's a little bit of a mix. We got some big customers out there. And again, our strategy has been when we do these conversions, not only do we convert our customers to a subscription model. But generally, we get a 3-year commitment on volume. So we expect to continue to execute on that. The only change that we've made and is relative to our desire to realize cash faster is to change our terms on the front end. So starting last quarter and into the next 2 quarters, you'll see our arrangement fee slightly different than it was in the first 6 months of the year or first 4 months of the year as we focus on getting more cash upfront, which I think will benefit the balance sheet and put it as a better position from a cash perspective.

Michael James Latimore - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Would that also change rev rec? Or is it really just on the cash side?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

No. It has no impact on rev rec whatsoever.

Michael James Latimore - *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

Okay. And then kind of once you're through this conversion, as you look into next year, would you expect most of the growth to come from new logos or from kind of current customers expanding?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Yes. Well, the whole reason we hired Brennen Carson and the rest of the sales team, which has been upgraded substantially this year, is to focus on those areas. One, we've got a major focus on our existing customers through our customer success program.

But the big change for us going forward after the base is converted is a clear focus on -- and working with our marketing team on new logos. And I think that will be the biggest difference. When you look at CalAmp year-over-year and in the next 6 months is that new logo focus, specifically in the key areas of transportation and logistics, not only in the U.S. but in EMEA and LatAm and an enterprise fleet in those same geographies.

Operator

The next question comes from Scott Searle with ROTH Capital.

Scott Wallace Searle - *ROTH Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Kurt, I want to wish you the best of luck going forward. It's always been a pleasure working with you. Just quickly, to dive in on the supply constraint side, it sounds like things are getting better on that front. I'm wondering if you were still constrained in the quarter in terms of what you ended up leaving on the table.

And as you're looking out to that mid-single-digit sequential growth what do you actually have visibility to in terms of what you can service? Is that what you already have in terms of visibility or parts be able to service that?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Yes. No, that's a complicated question. But absolutely, we could have done more in terms of revenue with a stronger supply chain. Having said that, we did see a significant increase in units shipped. So as I mentioned in my remarks, it did get better. We expect to see that progress even more in the third quarter. We're finally back to a point where customers can order and receive goods on certain of our solutions in the same quarter, which is a nice feeling.

That's been some time since we've been able to do that. And I think we will progress steadily over the rest of the year. Now -- when we think about CalAmp, we're a little bit different than most out there because of the sophistication of our solutions, and we have pretty high-end devices. And so our supply chain is a little bit different than, say, some of the more generic device players out there.

But nonetheless, it's good. We do see better visibility, especially in the third quarter. We're trying to really get ahead and work with everybody in the supply chain all the way to the semiconductor players, even though their relationships are more with our contract manufacturers. Our team, including me, have been in direct contact with everybody across the chain and in working very, very hard to improve the situation and improve the visibility. But it does feel good. It feels good to have the ability to meet our customers' demand to fulfill some of our backlog in the quarter.

Kurtis Joseph Binder - *CalAmp Corp. - Executive VP, CFO & Principal Accounting Officer*

And Scott, we look at is the historical run rate, especially within the Telematics Products. And with our backlog at an all-time high, I don't think it would be unusual to have expected that the -- at least the Telematics Product segment could have done maybe 20% more than where it was for this particular quarter. That's just going off of what we've done historically when you look at the quarterly run rate from the last 2 fiscal years.

Scott Wallace Searle - *ROTH Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Great. And Kurt, maybe to follow up on that point though, given the push to more of a recurring revenue stream, right? The expectation was that MRM would continue to come down on the Telematics side, right? But it seems like we're running above, I think, those longer-term levels that you thought it would get down to $10 million or so a quarter. So, is there a new higher sustained level of Telematics Product once you strip out the OEM business that you expect the company to be running at going forward?

Kurtis Joseph Binder - *CalAmp Corp. - Executive VP, CFO & Principal Accounting Officer*

No. I mean, I think as we've communicated in the past, our objective is to move a 100% of those MRM telematics device customers over to multiyear subscription arrangements. It only makes sense considering the post-sales support services that we tend to provide to those customers and really with the business use to what they're doing with our devices and our services. So I think ultimately, we will get all of those customers moved over.

And that then will represent 70% of our consolidated revenue, as Jeff mentioned. But I think that it's still going to happen over the course of this year. And there's still -- with the existing customers that are within the Telematics Product category, healthy demand that's sitting in that backlog. So it will come down, but it will come down gradually over an extended period of time.

Scott Wallace Searle - *ROTH Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Great. And lastly, if I could, on the subscription -- software and subscription services front was a big sequential uptick in the quarter. Are there any onetime events that are kind of mixed in there to kind of calibrate us on that front?

And also on that 1.3 million subscription figure that you have now, is it possible to give us an idea in the quarter the incremental net adds, how many of those were from conversions versus non-conversions?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Yes. I'll take the first part. Kurt will answer the second part regarding the subscriber growth. In respect to -- there weren't really any onetime items. I think that we benefited both from new logos selling full stack solutions to our customers as well as a pretty healthy success in terms of moving up our conversions. I think we're moving from something in the 30s to 50% in the quarter. So those were 2 things. No big onetime events there.

Scott Wallace Searle - *ROTH Capital Partners, LLC, Research Division - MD & Senior Research Analyst*

Okay. And just the subscriber net addition mix in the quarter?

Kurtis Joseph Binder - *CalAmp Corp. - Executive VP, CFO & Principal Accounting Officer*

Sure. Yes, Scott. So I would say it was split probably maybe like 80-20, where we have 80% coming from conversion 20% from new logos.

Operator

(Operator Instructions) The next question comes from George Notter with Jefferies.

Blake Mielke - *Jefferies LLC, Research Division - Equity Associate*

This is Blake Mielke on for George Notter. First, I just wanted to congratulate -- or rather wish you good luck, Kurt, moving forward. From what you're saying, it sounds like the remaining 50% of Telematics customers to be converted tilts towards larger customers. So should we expect the total opportunity remaining with these customers to be larger than 50%? And then I have a follow-up.

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Well, I think maybe you misheard me a little bit, but there's a couple of large customers in there. But there's also the tail of our smaller customers that will kind of bring over in one fell swoop. So we brought over -- as we said in our script this quarter, we brought over Localiza and Trimble, which are 2 of our larger customers. So it's a little bit of mix in terms of what we have in front of us.

There are a couple of large ones, but we also have that tail that I mentioned earlier, which tend to be smaller -- but the important thing is that we've really got this down to a science now, both in terms of how we work with our customers. They're seeing tremendous benefit to switching to the subscription model because the software that they utilize is giving them much improved capability. Our sales and technical teams are now that it's old hat to drive these versions.

Blake Mielke - *Jefferies LLC, Research Division - Equity Associate*

Okay. And then in terms of price increases, when should we expect those to fully work into the model? And is there any evaluation for additional rounds of price increases at this point?

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Well, we've steadily used something we term internally PPV or purchase price variance to offset, especially when we go out and do spot buys to opportunistically access low -- some products that are in high demand. We've done that steadily so that we -- and we've been able to pass those costs on to our customers. Now the PPV does lag a little bit behind some of the price increases that we see. So I think throughout the rest of the year, you'll see us both continue to use PPV as a tool. And that is as we see inflation and other cost increase in our in our BOMs look to opportunities to strategically use price increases to help offset some of that pressure.

Operator

There are currently no questions waiting in the queue at this time. So I'll pass it back to the management team for any closing remarks. Excuse me.

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

Thank you for joining us on the -- okay. you're teasing us. Okay. Go ahead, please.

Operator

Apologies. It seems they've removed their question, you may proceed with the closing remarks.

Jeffery R. Gardner - *CalAmp Corp. - President, CEO & Director*

No worries. Thank you for joining us on the call today and for your continued interest in CalAmp. As we look into the second half of our fiscal year, we remain focused on further expanding our SaaS transition program and securing new global customer logos to drive a higher level of future recurring revenue. We look forward to sharing our progress with you during our third quarter 2023 earnings call in December. Operator, you may now disconnect the call. Thank you.

Operator

This concludes the CalAmp Q2 Fiscal Year 2023 Earnings Conference Call. Thank you for your participation. You may now disconnect your lines.