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CAMP.OQ - Q3 2023 CalAmp Corp Earnings Call

EVENT DATE/TIME: DECEMBER 20, 2022 / 10:00PM GMT

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PRESENTATION

Operator

Welcome to CalAmp's Third Quarter 2023 Financial Results Conference Call. My name is Hannah, and I will be your moderator for today's call. (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 third 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; and Acting CFO, Cindy Zhang.

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're 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 recent operational highlights and then Cindy 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. Our third quarter revenue grew 8% sequentially to $78.9 million, which exceeded the high end of our expectations. This higher-than-expected revenue resulted from additional components which we secured in the spot market to meet our customer commitments. This created significant margin pressure in the quarter, but the fulfillment of these orders accomplished several objectives for both CalAmp and our customers, including the avoidance of business disruption for customers affected by Verizon's 3G network shutdown, and it allowed the fulfillment of aged order demand for our other customers.

Given the unpredictable nature of component availability and pricing in the spot market, as well as the strategic importance of the conversions, the team felt it necessary to absorb the margin pressure in order to fulfill these orders. We view this situation as transitory with some continued impact in Q4, but to a much lesser extent, and then return to a more normalized level of gross margin in early next fiscal year. Cindy will discuss the financial impact of this in more detail in a moment.

Turning back to our progress in the quarter. Our sales team has been working very hard to convert customers to recurring contracts while also setting the framework for securing new customers to drive our future growth. Our Software and Subscription Services revenue in the third quarter increased 11% sequentially to a record $49.3 million. Remaining performance obligations also increased by 20% sequentially to $252 million and the Software and Subscription Services subscribers increased 12% sequentially to 1.5 million.

Notably, we converted 2 large customers, Michelin and Navman, to recurring contracts in the quarter along with a number of other customers. As of quarter end, we have cumulatively converted approximately 75% of eligible customers to recurring contracts and are on track to substantially complete the conversion process for remaining customers by fiscal year end. Other software highlights during the quarter included a Software and Subscription Services renewal contract with our large parcels shipping customer, which is a multiyear, multimillion-dollar commitment. This customer has approximately 130,000 trailers outfitted with our edge devices and industry-leading telematics software platform, the CalAmp Telematics Cloud. We also secured Ford North America as a major new subscription customer during the quarter, and we launched our new GPS-based vehicle tracking solution, developed in collaboration with BMW, in Europe. We expect to see increasing revenue from this partnership in the quarters ahead.

Much of the recent business development success has been due to the focus between our sales and marketing groups to improve our go-to-market activities. Led by our CRO and our CMO, this joint activity has resulted in the implementation of a lead generation program that's enabled expanded opportunities for the company's sales team. This work is setting the foundation for systematically building the sales pipeline and securing new recurring customers.

On the product development side, I wanted to tell you about an exciting upcoming release that will represent a major milestone for our transportation and logistics strategy. Soon we'll release Cargo Insights for tracking shipments in our CalAmp application. This will be an innovative new user experience that will be simple to use and will make tracking and protecting assets even easier to manage.

As we have shared for a long time, our industry-leading CalAmp Telematics Cloud platform aggregates data from our large portfolio of edge devices and sensors installed on tractors and trailers, including those from our recent partnership with Hyundai Translead. We offer a plethora of trailer sensors for tire pressure, cargo door control, extreme temperature monitoring, tilt, shock, light, and other environmental factors. The CalAmp Telematics Cloud makes it easy to access data from these many sensors through APIs with 99.9% uptime in the cloud. But our new Cargo Insights application goes a step further. It will provide an industry-first experience that presents all this insight data in a single multi-sided application, one that will appeal to all functional departments across the transportation and logistics industry ecosystem. CalAmp's Cargo Insights gives visibility into the cargo on the trailer, the vehicle, and the driver. It adds critical accountability to the customer for protection against insurance claims, to maintain compliance with regulations, and to keep informed as each trailer of precious cargo proceeds down the highway. This new release brings our strategy to life for the benefit of our customers.

Before I hand the call over to Cindy Zhang, our Acting CFO, I would like to take this time to thank her for her support during our CFO transition. Cindy and her team have done an exceptional job and ensured that our financial operations have been maintained with a tremendous level of detail and attention. At the same time, I'd like to welcome our new CFO, Jikun Kim, who will be starting on January 9. He has a long, successful track record in executive financial management at various tech companies, including most recently as CFO of Momentus, Inc., a Nasdaq-listed space infrastructure company. Prior to Momentus, he served as CFO at tech firms Formlabs, EMCORE, Merex Group, and AeroVironment. Jikun received an MBA from Columbia Business School, an M.S. degree in Electrical Engineering from UCLA, and a B.S. degree in Electrical Engineering from the University of California at Berkeley. He'll be joining Cindy and me for the Needham Growth Conference on January 10, so those of you planning to attend that event will have a chance to meet him, even though only a few days after his start date.

With that, I now pass the call over to Cindy.

Xiaolian Zhang - *CalAmp Corp. - Senior VP of Financial Planning & Analysis and Acting CFO*

Thank you, Jeff. 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 third quarter earnings that was issued earlier today.

As Jeff mentioned, we had a strong revenue growth in the quarter, increasing 8% to $78.9 million compared to the prior quarter, and up 15% compared to the same quarter a year ago. Software and Subscription Services revenue was $49.3 million, up 11% sequentially and up 35% from the prior year, representing 62% of our consolidated revenue. Both the sequential and the year-of-year growth in the Software and Subscription Services business reflects the progress we are making converting eligible telematics device customers to recurring subscription contracts which contributed approximately $20 million to revenues in the quarter. At the end of the third quarter, we've converted approximately 75% of our total eligible telematics device customers and anticipate to substantially 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 third quarter was approximately $252 million, up 20% from the prior quarter and up 72% from the same quarter a year ago. During the quarter, our subscriber base increased to 1.5 million, up 12% sequentially and up 44% year over year.

Telematics products revenue in the third quarter was $29.6 million, which represented a 5% increase sequentially and an 8% decline year over year. Our largest customer represented $13.2 million of revenue for the quarter, which was up from $12.4 million last quarter but down from $14.4 million in the same quarter a year ago. Our backlog with this customer remains solid. Consolidated gross margin in the quarter was 33.7% compared to 39.8% last quarter and 40.7% in the same quarter a year ago.

As Jeff mentioned earlier, we had aged backlog demand. As essential components became available in the spot market, we made the decision to incur additional costs to secure these components to fulfill critical backlog, including for those customers requiring an upgrade to 4G ahead of Verizon's 3G network sunset. Some of these costs were passed on to our customers with the balance putting short-term pressure on our gross margin. This negatively affected gross margin in quarter 3 by $5.7 million or approximately 700 basis points. We anticipate gross margin to improve meaningfully in the fourth quarter, driven by lower levels of spot buys and to return to normalized levels early in the next fiscal year.

In the quarter, we continued our efforts to manage operating expenses and achieve operating efficiencies. As a result, third quarter non-GAAP operating expenses decreased by 6% sequentially and decreased by 10% over the prior year. Adjusted EBITDA in the third quarter was a $4.7 million compared to $4.8 million in the prior quarter and $3 million in the same quarter last year. Adjusted EBITDA remained flat sequentially, reflecting lower operating expenses offset by gross margin compression.

In terms of our overall liquidity position, at the end of the third quarter, we had total cash and cash equivalents of approximately $45 million as compared to $48 million last quarter. The sequential decline in total cash and cash equivalents was due to an increase in deferred billings or unbilled receivables as a result. At November 30, 2022, there were no borrowings outstanding under our $50 million revolving line of credit. Total net borrowing capacity on this line, based on eligible accounts receivable and inventory at November 30 was $36 million. Our aggregate outstanding debt is approximately $232 million, including $230 million at the 2% convertible senior notes due August 2025.

In reference to our outlook for the fourth quarter of 2023, the company is maintaining its policy of not providing detailed quarterly guidance. However, given the significant volume of shipments in the third quarter, the company expects fourth quarter revenue to be relatively flat sequentially.

With that, I'll turn the call back over to Jeff to provide some final comments. Jeff?

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

Thank you, Cindy. And I'm proud of our team for continued progress we have made towards achieving our goal of converting all eligible customers to recurring software contracts by fiscal year end, while continuing to secure additional new logos around the globe to drive our future growth.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from the line of Michael Latimore with Northland Capital Markets.

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

Yes. Congrats on the strong revenue results there. Question on the guidance for the fourth -- or the notion that revenue would be, say, flat sequentially in the fourth quarter and you talk about converting the rest of your software and subscription customers, so going from 75% up to almost 100%. To me that would imply some growth at least on the Software and Subscription side. So should we think about Software and Subscription growing sequentially and the rest of the business down a little bit, or how should I sync those 2 comments up?

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

Yes. Good question. So the way we looked at it, if you look at our second half, consensus was $152 million. The spot buys allowed us to pull in some orders into the third quarter. So that's why we're talking about flat sequentially. We've done a lot of the heavy lifting on the conversions. We've just got a couple of our big customers to do in the fourth quarter and then it would be most of our smaller customers. So, in terms of the fourth quarter, we said that it would look a lot like the third quarter, but when you look at the comparison to our revenue production in the second half versus consensus, it's up quite a bit. So we're really happy about that.

I think 2 things that I'll also add. On our new contracts for the conversions, we're getting our cash upfront, which is important for long-term cash flow and puts us in a better position. Remember with all of these contracts, we're getting 3-year minimum commitments from each of our customers. So really pleased that the sales force has been extremely focused on that. And long term our goal was to build a company here that has much more predictable recurring revenue, and I think we're on track for that.

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

Okay, got it. And then on the Software and Subscription EBITDA, can you provide what that was in the quarter? I think you will, at least, in your 10-Q. If you can, now. And then what do you view as a normalized EBITDA margin for your Software and Subscription business?

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

Yes, I'll start that and maybe Cindy can jump in. First of all, this is an unusual quarter with the spot buys. So looking at our gross margin this quarter does not give you a good picture of what it's going to look like long term. Longer term all of our Software and Subscription businesses we believe is 50-plus percent gross margin. And when you combine that with our equipment business which is shrinking that we believe in the long term we're going to move more towards that 50% range. That's our long-term goal.

So, again, Cindy talked about some of the expense cuts that we made in the quarter. We continue to improve the efficiency of the business as we move more towards a software company, and I think you'll see long-term the margins grow from historically in the 40% range closer to the 50% range, which still remains our long-term goal.

Operator

Our next question is from the line of George Notter with Jefferies.

George Charles Notter - *Jefferies LLC, Research Division - MD & Equity Research Analyst*

I guess I was just curious about the backlog metrics in the company. I know you guys don't explicitly guide to backlog or talk to backlog, but maybe you can give us a sense for what happened. I assume it was down sequentially. I'm just wondering if there is a significant backlog left here or you've worked most of it down. Where are you with that?

And then also I was just curious about the impact you're getting from the Verizon 3G sunset, any sense for how much incremental telematics revenue you might have gotten this quarter just as you're shipping against that opportunity and what that stepdown might look like once we get past that sunset?

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

In terms of our backlog, we were finally able to fulfill some of our backlog. We finally were in a position with the spot buys, that I mentioned earlier, to take some of these older POs for our customers and many of those were to support them as we move toward the Verizon transition.

I think that as we -- the Verizon transition being a high point for revenue, I don't really feel that way because we've been fulfilling against that for the year. There was some incremental demand this quarter. But again, I think as we convert our business, convert our existing customers to 4G, it puts our sales force in a better position to sell our Software and Subscription Services revenue. So I don't feel like we had some unnatural demand driven by the 4G. We've been fulfilling against that all year, and we're anxious to get -- our transformation step 1 was to convert the base. We're almost there. We're going to get there in the fourth quarter, and then I'm really excited about our ability to fulfill against our transportation and logistics and enterprise fleet opportunities, which are more full-stack solutions with higher ARPU in 2024 and beyond.

Operator

Our next question is from Jerry Revich with Goldman Sachs.

Clay Williams - *Goldman Sachs Group, Inc., Research Division - Associate*

This is Clay Williams on for Jerry. Just going back to the long-term target of 50% gross margin, can you help us think about the timing and trajectory to get there as you continue to expand the installed base?

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

Yes, Clay. We're going to make significant progress next year. When you look at the fact that we did 62% SS&S this quarter, and at the same time, as we're seeing that growth in Software and Subscription Services, we're seeing very good improvement in our cost. We've been really working hard on our cost structure. I believe Cindy talked about 6% down sequentially and 10% down year over year. That's a reflection of this company transforming into a software company. And so I think that it's hard to give you specific guidance as to when we get to 50%, but we definitely think we'll make significant progress. We're well set up for that to make progress towards that goal in fiscal year '24, which begins in March of 2023.

Clay Williams - *Goldman Sachs Group, Inc., Research Division - Associate*

And a quick follow up on subscriber growth. As you mentioned, we are going towards that -- coming to the end of the conversions here at the end of the year. How should we think about subscriber growth in '23 and even longer term?

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

Yes. So yes, it's been a banner year for subscriber growth, and a lot of that's had to do with our conversion to a subscription model, getting our customers on our device management platform. That's been really good. I think what our investors have to look forward to is maybe slightly slower growth in 2024 in terms of absolute subscriber growth, but much higher growth in terms of ARPU as we add more full-stack solution customers, enterprise fleet, transportation and logistics.

What I'm excited about is when I talk to my sales leader, Brennen Carson, who's brought in a lot of domain expertise in terms of transportation and logistics and enterprise fleet. Why we're doing these conversions? We're building a really excellent pipeline for future growth, and those are at much higher ARPU. So, again, I think you'll see slightly slower growth in terms of absolute subscribers but at much higher ARPU.

Xiaolian Zhang - *CalAmp Corp. - Senior VP of Financial Planning & Analysis and Acting CFO*

Yes, Jerry, this is Cindy. I just want to add that in the SaaS conversion deals, right, multiple deals actually are 3-year based, and we have minimum guarantees with the customers. So we would -- as Jeff mentioned, we would still expect good growth in terms of number of subscribers in the next year -- next several years, right, within the current arrangement. And we hope there will be more to come in the future. So we have good confidence on the number of subscriber growth in the years to come.

Operator

(Operator Instructions) The next question is from Scott Searle with ROTH Capital.

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

I apologize for my earlier technical difficulties. Hey, a couple of quick clarifications. I'm not sure if I heard an OEM mix number. I heard a Caterpillar number, but I was wondering if there was a total OEM number that you provided. And then also within the Software and Subscription Services, big number this quarter. You did sign some other extensions on some existing customer contracts. I'm wondering if there were any larger one-time benefits in there. If you could break that out. Then I had a couple follow-ups on the gross margin front.

Xiaolian Zhang - *CalAmp Corp. - Senior VP of Financial Planning & Analysis and Acting CFO*

Maybe, Jeff, I'll answer the OEM question. You can handle the rest. So, Scott, the OEM in the past couple of years, we had multiple customers there. Caterpillar is one of the biggest one. We actually successfully converted some of the core OEM customers into SaaS business already in the past one year, so the leading customer or almost the major customer in this OEM category is Caterpillar. So the Caterpillar revenue, honestly, is very, very representative of the total OEM business revenue. So specifically for quarter 3, the total OEM revenue was about $13.5 million, with Cat at $13.2 million there.

And as we mentioned, the demand with this customer remains solid, and we do hope we can continue to grow the business when our supplies continue to support.

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

And then -- yes, thanks, Cindy, that was great answer. And on the software side, we did have some big conversions. We had a very successful quarter getting Michelin and Navman, 2 of our top 6 customers converted, so that helped a lot. We also in addition to the large parcel delivery company that we mentioned multiyear multimillion-dollar contract, we also signed another extension for Commonwealth of Pennsylvania, another large enterprise fleet customer that delivers multimillion-dollar revenue each year.

So I think you're seeing some very good things with respect to Brennen Carson, our Chief Revenue Officer, has been here for about 6 months. He seeded his sales leadership with an extensive amount of domain knowledge, and I can see our pipeline growing each and every quarter. So, yes, it was a great quarter with good numbers, but we want to keep putting up those numbers going forward, Scott. And that's really what this transformation is all about.

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

Hey, Jeff, but just to clarify, in terms of that $49 million, are there one-time software sales in there or any large component that's one-time that we should not expect to be recurring as we go into future quarters?

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

I don't believe so. It's pretty much our normal mix. So yes, I don't think there's any large one-time in there that would be unusual that we need to call out so that you can model going forward.

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

Okay, very helpful. And lastly if I could, on the gross margin front, I want to make sure I clarify a couple of numbers. I thought it was $5.7 million in terms of the negative cost related to the product front, so 700 basis points overall from a gross margin standpoint. Just want to clarify that number.

And then the recovery, it sounds like you're recovering in the immediate quarter. Can you give us some idea as to the magnitude of that recovery? And you talk about normalizing, and I think in the most -- last 2 to 4 quarters normalized I think has been more in the 28% to maybe 30%-plus range on the product front. Is that where we're going to in the first half of fiscal '24?

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

Yes. What was unique about the third quarter, we had an unprecedented level of spot buy opportunities. How should investors think about that? I'll tell you how we think about it. As the supply chain continues to improve, the first sign of that is the spot-buy opportunities, right? So these are customers who didn't use their full allocation, who sold their product to these brokers, and made it available in spot markets.

So, I think, long term what we see and into the first quarter as we look at our forecast, that our allocations are improving. We're seeing our vendors really step up in terms of providing extra capacity. We've got one of our contract manufacturers expanding their production into Vietnam, bringing on new capacity, and we got Texas Instruments building some capacity in the U.S., which is also going to allow us to source more in the normal markets, not with the spot buy opportunity. So that means good things in terms of margin.

In terms of the fourth quarter, I think the recovery -- we said we're going to see a significant or meaningful recovery in the fourth quarter. That means on 2 fronts, because when you talk about the spot buy, there's 2 parts of it: one is how much do we pass on to our customers and what are the spot buy opportunities. So, we believe our spot buy activity will be much less, even as much as half, as much as the first quarter, and we'll be able to pass on more to our customers as we've worked through this.

We were under an extraordinary amount of pressure in the third quarter because of the impending transition. So now that that's going to be falling away, we're in a much better position to work with our customers on this to find the best way to bring on this additional volume. What I'm really pleased about, and I think we earned a tremendous amount of goodwill for our key customers, some of which had orders that were as old as 6 or 9 months outstanding to deliver 4G product to them in advance of the January 1 Verizon shutdown.

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

Jeff, quickly if I could follow up on that front. It looks like you added about 150,000 customers sequentially, which is a pretty big number. Part of that is the ongoing 3G to 4G migration. I want to say that the existing base that we needed to be converted over was somewhere in the ballpark of 200,000 or so. Is that correct? And so then using straight line math, maybe rounding a little bit, that non-3G upgrade customers are somewhere in the 50,000 to 75,000-plus net additions in the quarter. Is that the way to think about the non-end-of-life 3G contribution?

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

We think the customers that we delivered -- I'm trying -- that's a complicated question, but we believe that -- I believe the numbers were something like 80,000 to 100,000 of product that we delivered to serve our customers who needed to do the 4G transition, or in other words, they needed to get that product before the Verizon cutover, so the balance would be more traditional. Our shipments increased about 25% in the quarter, and so most of that was not just 3G. Some of it was, the incremental part, but we still had very strong shipments across the board to our customers as the supply chain improved. Now it improved because of the spot market this quarter, but we expect that improvement to continue into the fourth quarter and fiscal year '24.

Xiaolian Zhang - *CalAmp Corp. - Senior VP of Financial Planning & Analysis and Acting CFO*

I want to add -- yes, I just want to add a little more color. When we made the decision to do spot buys in quarter 3, actually a majority of the spot buy expenses were to support our Telematics products business, as you can see from the 10-Q we filed, our actually Telematics products business got harder on gross margin. So when we report our number of subscribers, it is actually more related to our SaaS business. We think the SaaS business actually, in terms of the subscriber growth, we can still talk about the 80:20 rule, right. 80% of the subscriber growth is driven by the SaaS conversion, 20% is driven by new logos and the renewals, et cetera. So the point is, the 3G, 4G, that impact actually was more towards our Telematics product, but in our Subscriber business, it is actually more very active support to the new customers we just converted.

Operator

(Operator Instructions) There are no additional questions waiting at this time, so I would like to turn the call over to Jeff Gardner for any further remarks.

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

Well, thank you, and thank you for joining us on the call today and for your continued interest in CalAmp. As I mentioned earlier, we'll be attending the Needham's Growth Conference again in January in New York, but this time in person, so that'll be nice. So please feel free to schedule a meeting with us if you're planning to attend. We look forward to sharing our progress with you during our fourth quarter of 2023 earnings calls in April of next year. We hope you all have a wonderful holiday season and appreciate your time today. Operator, you may now disconnect the call.

Operator

That concludes today's call. Thank you for your participation. You may now disconnect your lines.
