

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

ITRN - Q4 2019 Ituran Location and Control Ltd Earnings Call

EVENT DATE/TIME: MARCH 04, 2020 / 2:00PM GMT



CORPORATE PARTICIPANTS

Ehud Helft CCG Investor Relations Inc. - Managing Partner - Israel

Eyal Sheratzky Ituran Location and Control Ltd. - Co-CEO & Director

Udi Mizrahi Ituran Location and Control Ltd. - Deputy CEO of International Operation & VP of Finance

CONFERENCE CALL PARTICIPANTS

David Lee Kelley Jefferies LLC, Research Division - Equity Analyst

Sasha Karim Inflection Point Investments LLP - Partner & Portfolio Manager

Tavy Rosner Barclays Bank PLC, Research Division - Head of Israel Equities Research

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. Welcome to Ituran's Fourth Quarter and Full Year 2019 Results Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. You should have all received by now the company's press release. If you have not received it, please contact Ituran's Investor Relations team at GK Investors & Public Relations at 1 (646) 688-3559 or view it in the News section of the company's website, www.ituran.co.il.

I will now hand the call over to Mr. Ehud Helft, GK Investor -- of GK Investor Relations. Mr. Helft, would you like to begin?

Ehud Helft - CCG Investor Relations Inc. - Managing Partner - Israel

Yes. Thank you. Good day to all of you, and welcome to Ituran's conference call to discuss the fourth quarter 2019 results. I would like to thank Ituran management for hosting this conference call.

With me today on the call are Mr. Eyal Sheratzky, the co-CEO; Mr. Udi Mizrahi, Deputy CEO and VP Finance.

Eyal will begin with a summary of the quarter results, following by Udi, with a summary of the financials. We will then open the call for the question-and-answer session.

I'd like to remind everyone that the safe harbor in the press release also cover the content of this conference call.

And now, Eyal, would you like to begin, please?

Eyal Sheratzky - Ituran Location and Control Ltd. - Co-CEO & Director

Thank you, Ehud. I'd like to welcome all of you, and thank you for joining us today. 2019 [ends] a tough year for Ituran. So I'm pleased to say that we believe the fourth quarter finally represent the bottom and the turning point. Looking ahead, I expect to show sequential growth throughout 2020. I will spend the next few minutes diving into the details of both the aftermarket business as well as the OEM business, as our overall consolidated financial results with the actual details.

In addition, in today's results, we provided you with a subscriber breakdown of the 2 main segments of our business to give you more tools to which to analyze our performance. And as you can see, the retail aftermarket business has recovered. And this is now the third quarter with net subscriber adds on the aftermarket side at about 20,000 subscriber.



Now I'm going into more details. The aftermarket business in Israel remained stable in 2019, and we are pleased with our continued positive performance in this market. Our leading market share has remained stable now for many years. New car sales in the country were slightly below, about 5%, what they were in 2018. And while there are some shifting trends within, the market itself has been mostly stable. Our Ituran SVR product remained an attractive proposition and has been a key driver towards our net subscriber growth in the market for a number of years.

We expect the aftermarket business in Israel to continue to grow, subject to the new car sales trend in the country, but as always, we continue to consider strategies for penetrating additional segments. One of our growth drivers in Israel is our UBI offering. The insurance policies are built around Ituran's solutions for taking into account a driver's accumulated mileage and behavior as it relates to safety. So insurance premiums can be directly related to usage, which is better for the driver and better for the insurance company in terms of managing risk.

In the past few months, we have signed on 2 insurance companies for our usage-based insurance service, Harel and Shlomo Insurance. We've already seen some early success with initial customers from these 2 insurance companies that are paying us a monthly fees. Beyond that, we see strong interest throughout the market and we are close to signing up other insurance companies to our services.

We expect to see an increasing contribution to our subscriber base and revenue in 2020 and beyond from this growth engine. Longer term, once we prove success in our home market of Israel, a synergy from the fact that we are now operating in a number of countries, is that it will be simpler for us to leverage this solution into our other markets.

Looking at Brazil now. As we discussed over the past few quarters, the aftermarket business there faced significant challenges, starting from the second half of 2018 and up to early to mid-2019. We solved those challenges and made changes to our Brazilian business model and system. We expect to continue our aftermarket subscriber goals at this solid pace.

I would like to spend a few moments talking about the aftermarket in Mexico, which is a new initiative for us. We are building our new ICS, which stands for Ituran com Seguro, program in Mexico. Taking the product, which has been successful in Brazil, reproducing and adjusting it for the Mexican market. We expect to launch and to start selling the product during the second half of 2020, which will have a more significant impact to our revenues in 2021.

And now our OEM business in Brazil and Argentina. As we discussed earlier this week -- this year, because of the weak economic situation in Brazil and Argentina, our major OEM customer has been looking for ways to reduce its cost and increase margins. Earlier in the year, they cut their subsidized free trial period for new car buyers from 6 months down to 3 months, and this had an immediate negative impact on our number of subscribers in those countries in the second quarter.

In the fourth quarter, they cut the free trial further down to 1 month, which was the primary cause of the OEM subscriber decline in the fourth quarter, and that it will continue to decline our subscriber base in the OEM operation of Brazil and Argentina.

In light of the reduced revenue related to this customer, in the fourth quarter and currently in the first quarter, we have implemented changes to improve our margins in this segment, including reducing manpower and rationalizing costs, which will benefit us in the coming quarters. Due to all of the issues I've just mentioned, we have recognized an impairment loss this quarter, which you can see in our results. I stress that this impairment is a noncash accounting charges for our results.

I want to take a minute to discuss the coronavirus issue. We are not seeing significant direct impact. So the impact it is having on the macro economy can indirectly affect us. We estimate that between \$1.5 million to \$2 million of hardware revenues and several hundred thousand dollar of profit could shift from the first to the second quarter, due to delay in the hardware shipment, mainly to Mexico.

In summary, 2019 was indeed not an easy year for us. While our aftermarket business began its recovery, the OEM business in Brazil and Argentina was particularly difficult throughout the year. However, looking ahead, we believe the worst is finally behind us. And we expect to see continued sequential growth into the first quarter and beyond throughout 2020.

Beyond that, we continue to see growth engines, the UBI business in Israel. We will also continue to expand our existing services and competencies to the new countries in which we now operate.

We are gaining traction in the Indian market. Our JV in India is moving ahead successfully, and we are currently running pilots with various potential customers. We feel the market is waking up to our offering. My overall goal is that Ituran will always create value for each shareholders by remaining at the forefront of the technological advancement in an ever-changing consumer-oriented mobility market.

I will now hand the call over to Udi for the financial review.

Udi Mizrahi - *Ituran Location and Control Ltd. - Deputy CEO of International Operation & VP of Finance*

Thank you, Eyal. I note that the results I present will be on a non-GAAP basis, including adjusted EBITDA, which exclude revenue and cost related to the purchase price allocation. We believe this will provide a better understanding of our ongoing performance. For further details with regards to the reconciliation between the non-GAAP and the GAAP results, please see the tables published with the press release.

Non-GAAP revenues for the fourth quarter of 2019 were \$66.2 million, representing a decrease of 17% compared with revenues of \$79.4 million in the fourth quarter of 2018. Revenue breakdown was \$50.3 million coming from subscription fees, a 9% year-on-year decrease. This decrease mainly relates to the Brazilian-Argentina OEM operation where the free trial has been reduced from 6 months to 3 months.

Ituran added 22,000 net subscribers aftermarket during the quarter, and there was a similar 22,000 decline in the number of OEM subscribers. Product revenues were \$15.8 million, which were a 34% decrease over the same quarter last year, primarily due to the lower contribution from the OEM business.

The geographic breakdown of revenues in the fourth quarter was as follows: Israel, 43%; Brazil, 31%; rest of the world, 26%. Non-GAAP operating profit for the fourth quarter of 2019 was \$11.8 million compared with an operating profit of \$18.9 million in the fourth quarter of 2018. Operating loss for the quarter was \$16.4 million, which includes an impairment loss of \$26.2 million related to the acquisition of Road Track Holdings, which was acquired in the third quarter of 2018. Excluding this impairment loss, the operating profit would have been \$9.8 million, 15% of revenues.

It is important to note that this impairment is a noncash charge. Adjusted EBITDA for the quarter was \$16.6 million compared to an EBITDA of \$25.2 million in the fourth quarter of 2018. Finance income for the quarter was \$3.3 million compared to a financial expense of \$1.4 million last year. Those finance income in the quarter includes a \$4.7 million income, which relate to the impairment loss, as I discussed a few moments ago.

Non-GAAP net profit was \$6.6 million in the quarter or fully diluted EPS of \$0.31 compared with a net profit of \$12 million or fully diluted EPS of \$0.56 in the fourth quarter of 2018. Cash flow from operation during the quarter was \$17 million.

Now for the full year results. Revenues for 2019 were \$283 million, an increase of 12% compared with revenues of \$253.6 million in 2018. In local currency terms, revenue increased by 16% year-over-year. Revenue breakdown for the year was \$208.4 million coming from subscription fees, up 15% year-over-year. In local currency terms, subscription revenues increased by 21% over those of last year. Product revenues were \$74.6 million, up 4% year-over-year.

Non-GAAP operating profit for 2019 was \$57.1 million compared with an operating profit of \$63.3 million in 2018. Note that our GAAP operating profit does include the impairment loss of \$26.2 million that I mentioned earlier. Adjusted EBITDA for the year was \$76.7 million compared to an EBITDA of \$79.2 million in 2018. Finance income for the year was \$0.6 million compared to financial income of \$0.7 million last year. As I mentioned earlier, the finance income in the quarter included a \$4.7 million income related to impairment loss.

Non-GAAP net income in 2019 was \$33.3 million or fully diluted earnings per share of \$1.58. This is compared to a non-GAAP net income of \$47.8 million or fully diluted share of \$2.27 in 2018. Cash flow from operation for 2019 was a record of \$59.7 million. As of December 31, 2019, the company had cash, including marketable securities, of \$54.3 million and debt of \$67.9 million, amounting to a net debt of \$13.6 million. This is compared

with cash, including marketable securities, of \$53.3 million and debt of \$73.2 million, amounting to a net debt of \$19.9 million as of December 31, 2018.

As of December 31, 2019, Ituran had repurchased a total of 228,000 shares amounting to approximately \$6 million. For the fourth quarter, a dividend of \$5 million were declared. The dividend's record date is March 24, 2020, and the dividend will be paid on April 7, 2020, net of taxes and levies at the rate of 25%.

And with that, I'd like to open the call for questions-and-answer session. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question is by Tavy Rosner of Barclays.

Tavy Rosner - Barclays Bank PLC, Research Division - Head of Israel Equities Research

I got disconnected for 2 minutes. So apologies if you already touched on some of the -- the questions. First, about the OEMs. You mentioned that 2019 was a challenging year, especially Brazil, Argentina, but that seems to be the bottom with 2020 shaping up to be a better year. So I guess, can you run us through the dynamics through the different geographies? And I'm also interested in any additional color on the cost-cutting measures you touched on in Latin America.

Eyal Sheratzky - Ituran Location and Control Ltd. - Co-CEO & Director

Tavy, first of all, we mentioned that we expect that the bottom of the declining in our results happened in Q4, after the situation that we had to manage during 2019, which I would divide it to 2. First is the recovery that we had to do in our aftermarket in Brazil, that started in the end of 2018, and we changed the model. This is something that had some effect until the end of 2019. Although we -- almost third quarter after we succeed to recover going back the subscribers in terms of the results, it's taking some time, and I'm expecting that Q4 was, again, the bottom line for this situation.

The second issue was, if you remember, the Mexican situation with the telcos that declared that they will shut down the 2G systems in 2 years from now and our customer asked us to change the modules to 3G. And it's took us also a major part of 2019, and we start to recover those sales only around September and October, which now is in a very good term.

And this is in the -- and the third issue is the OEM. So I didn't -- we did -- I didn't say that the OEM, which I want to be more specific. The OEM customer in Brazil and Argentina change around during the last year. It changed the conditions of the free trial period from 6 months to 3 months, and recently, which will affect -- which affected the last quarter of 2019.

And probably will continue to affect, but much, much lower numbers -- much, much lower effect in the coming few 1 or 2 quarters is changing to a 1-month free trial. When it's a 1-month free trial, it's mean that there is more churn. It's mean that it's more difficult to recruit payment customers after this month. That's something that we faced in Q4, and it will affect in the coming quarters.

The second aspect is that every new customer is also integrate with the hardware that we sold to this car manufacturer in the last 4 years. And since 2019, looking forward to 2020, the numbers or the revenues from selling hardware to this specific customer, in this specific geography, will continue to decline.



So we said in the past, and I will say it again now, that we're going to offset it during the 2020 from 2 major resources. One of them is that the aftermarket, as you can see, is growing again, and it will start effect more materially in our P&L in the coming quarters. And this should at least offset the decline in the OEM in Brazil and Argentina.

And second, we expect, based on the current situation in Mexico, Ecuador and Colombia to increase or at least to keep the same numbers for 2020. So these 2 resources, we have the reason to believe will be -- will offset and will be even higher than the declining in the OEM in Brazil and Argentina.

And by saying this, the overall consolidated business of Ituran should now sequentially increase every quarter. So in terms of the numbers, we hope, we believe, we have confidence that Q4 was the bottom line of the fundamental results.

Tavy Rosner - *Barclays Bank PLC, Research Division - Head of Israel Equities Research*

Yes. That's very clear. And maybe something I might have missed, but the impairment at Road Track, what was the reason that triggered it?

Eyal Sheratzky - *Ituran Location and Control Ltd. - Co-CEO & Director*

Basically, it's a very accounting issue, and I will explain. When we acquired Road Track, and it's not related specifically to the value or the -- how the economic value of the acquisition. It's basically when you acquire a company, you have to write some assets, which is the difference between the equity and the value. And this is based on some scans that you have to use third party's accounting firm to evaluate these differences, and since it's based on some perpetual numbers.

And as you know, it was affected by the Brazilian and Argentinian business forecast. We didn't expect that they will reduce the free trial from 6 months to 1 month. So it's mean that all the decline that the market sold during this year, it's actually affects the value of this number in our balance sheet. And in order to be conservative and to obey the accounting rules after this kind of acquisition, we had to do this accounting move and we put this number.

As Udi mentioned, it's -- has no any influence, not from the operational point of view and not from a cash point of view.

Operator

Next question is by David Kelley from Jefferies.

David Lee Kelley - *Jefferies LLC, Research Division - Equity Analyst*

Could you update us on the OEM renewal rates? I know you've talked about that 35% range. Just curious how that's tracking with the shorter free trial length.

Eyal Sheratzky - *Ituran Location and Control Ltd. - Co-CEO & Director*

The renewal rate is actually on the same rhythm, as you mentioned, around the 35%. Of course, it diversified between the different markets. Some of them, we have more. Some of them, we have less. But the numbers, specifically in Brazil and Argentina, become lower. So the absolute numbers is lower. In terms of percentage, we succeed to keep at least the percentage of the 35%.



David Lee Kelley - Jefferies LLC, Research Division - Equity Analyst

Okay. And could you provide some color around the magnitude? You referenced the lower cost and some of the synergies you're looking to create in Brazil and Argentina between the 2 businesses. How should we think about the dollar magnitude of that impact in 2020?

Eyal Sheratzky - Ituran Location and Control Ltd. - Co-CEO & Director

We can't give the number. But as I said, I believe that Q4 and some influences from Q1, including some severance costs and some downsizing, and integrate it to the Ituran aftermarket team, will allow us to stop, to stop and to enjoy this benefit -- or benefit from it in 2020, probably from somewhere around Q2, Q3, when I believe that from this moment, we will no longer declining our profits in this segment, specifically in Brazil and Argentina.

David Lee Kelley - Jefferies LLC, Research Division - Equity Analyst

Okay. And then last one for me. You referenced the shift in the OEM business away from hardware sales to more of a services model. I guess, how do you see that playing out as far as the margin impact of that shift over the next year to 2 years?

Eyal Sheratzky - Ituran Location and Control Ltd. - Co-CEO & Director

First of all, I wish that we have more sales, also of hardware because the margins are lower, but the absolute number is higher. And in the end, we will have more profits. But talking about the current situation, I believe that, again, from the moment that we will finally put the team, the company in the final stage after the full downsizing around April or May, from that moment, we believe that these specific segments will have higher margins.

This is one of our aim to do in the coming -- in the last month and in the coming months, but it will increase. But don't forget that this is only part of our OEM business, and we have in Mexico, Colombia and Ecuador, very material business, which is continue to sell hardware, even more than in the past.

So the overall OEM business, I wouldn't say that it will have higher or material higher margins, but I expect that toward 2021, we at least will see more our growing numbers, subscribers and profits. During 2020, still the downsizing in Brazil and Argentina will affect the total OEM business.

Operator

Next question is by Sasha Karim of IPI.

Sasha Karim - Inflection Point Investments LLP - Partner & Portfolio Manager

First question for me. You've made it very clear that Q4 was the trough. I just want to be a bit more specific. Would you say that Q4 was the trough for revenue and also for your non-GAAP EBIT?

Eyal Sheratzky - Ituran Location and Control Ltd. - Co-CEO & Director

Yes. Again, expectation is based on what we see and how we recovered the Brazilian aftermarket. It's how we recover the Mexican market. I just mentioned that in Q1, we're going to have some effects from the corona. I don't think it will change those expectations.

But as long as the numbers is, as I mentioned, something like a few hundreds thousand of dollars in the EBIT. So if this is the case, we expect to start increasing quarter-over-quarter the EBIT, the EBITDA, the profits. Yes, this is the case. Of course, from a GAAP perspective, of course.

Sasha Karim - *Inflection Point Investments LLP - Partner & Portfolio Manager*

Yes. My next question would be, can you give us an update on roughly what is the revenue per UBI sub in Israel?

Eyal Sheratzky - *Ituran Location and Control Ltd. - Co-CEO & Director*

I can't give it specifically because it's part of our total ARPU, but it's a lower and it's something like a few dollars per month. It's not the same as the typical ARPU of the other services, but we expect that the numbers of subscribers in the future, more mid- and longer-terms, will be much higher, much larger growth than the SVR.

And second, don't forget it. For the other services, we have cost integrated, too, which is, for example, the control centers, the customer support, it's a more B2C. This is a pure B2B, almost no cost integrated with those revenues. So it's a few dollars, but almost 100% of this few dollars goes to the EBIT.

Sasha Karim - *Inflection Point Investments LLP - Partner & Portfolio Manager*

Understood. Just to be clear that you're saying that you think the addressable market in terms of number of subs is higher than in SVR?

Eyal Sheratzky - *Ituran Location and Control Ltd. - Co-CEO & Director*

Theoretically, for SVR, it's depend on, let's say, on the actuary needs of the insurance companies, which derived from how many of a specific model is popular amongst fix. And this is -- puts our penetration potential in something like 20%, 25%, 30% of the total car audience.

Once the insurance market in Israel will be covered by all the insurance companies based on how a person has drive or how many mileage he's drive, if most of the people, it will be more -- it will be cheaper. It will be more efficient for them to buy this kind of policy.

So then it doesn't -- it's doesn't matter whether you have an old car, a very old car and brand-new cars, if it will be efficient for the customer, so he will take the decision to buy. So if in Israel, there are millions of old cars that no longer subscribe for SVR, potentially, they can be our customers, potentially.

Sasha Karim - *Inflection Point Investments LLP - Partner & Portfolio Manager*

Yes. Understood. And finally for me, just on India. You talked about some early progress there. And we saw that you launched your JV with Lumax a while ago. Can you just give a rough indication of when you might be able to do a full launch? And which regions, if so? And would it be mainly for the SVR business through insurance channel or through the retail channel or anything else?

Eyal Sheratzky - *Ituran Location and Control Ltd. - Co-CEO & Director*

The Indian market -- our offering to the Indian market, together with our partners, is almost -- only B2B, meaning going to whether it's car manufacturers, whether it's large fleets, whether it's leasing or rental companies. So this segment sales cycle is much longer. And specifically, when you go to a premature geography premature market.

And also, there is a very large challenge, which is the pricing to this -- in this geography. So all those differences from the SVR and the B2C, which Ituran is doing in the other geographies, here, it's taking more time.



When I said that it's going very well is because we see a traction from large customers like large commercial customers. But we are now in a pilot mode, we are in negotiation mode and I believe that it will take a little bit more time. I would say, and I said it that during 2020, it will not be significant to our results. I believe that in 2021, we can -- or I want to believe that in 2021, based on the steps that we do now and the relationship that we have now with potential customers and tenders, in 2021, we will be able to declare some more major deals.

Operator

(Operator Instructions) There are no further questions at this time. Before I ask Mr. Sheratzky to go ahead with his closing statement, I would like to remind participants that a replay of this call will be available tomorrow on Ituran's website, www.ituran.co.il.

Mr. Sheratzky, would you like to make your concluding statement?

Eyal Sheratzky - Ituran Location and Control Ltd. - Co-CEO & Director

Yes. Thank you. On behalf of the management of Ituran, I will like to thank you, our shareholders, for your continued interest and long-term support of our business. I look forward to speaking with you next quarter.

Have a good day. Bye.

Operator

Thank you. This concludes Ituran's Fourth Quarter and Full Year 2019 Results Conference Call. Thank you for your participation. You may go ahead and disconnect.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2020, Thomson Reuters. All Rights Reserved.