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Lesaka Technologies, Inc. (LSAK)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, everyone, and welcome to Lesaka's Fiscal First Quarter 2023 Webcast and Conference Call. As a reminder to everyone that the webcast is being recorded and the presentation can be accessed through the webcast link as well as dialing into the Zoom conference call dial-in numbers provided. Management will address the questions you may have at the end of the presentation.

For those joining us via webcast, you can ask your questions live by raising your hand in Zoom. For those joining via the Zoom teleconference line, you cannot ask your questions live. The webcast link, Zoom conference call dial-in numbers, as well as our press release and supplementary investor presentation are available on our Investor Relations website at ir.lesakatech.com. Additionally, the company filed its Form 10-Q after the US market close on Tuesday, November 8, 2022, which is also available on our Investor Relations website.

As a reminder, during the call, we will be making forward-looking statements, and I ask you to look at the cautionary language contained in our Form 10-Q regarding the risks and uncertainties associated with forward-looking statements. Also, we will be discussing our results in South African rand, which is non-GAAP. We analyze our results of operations in our press release in rand to assist investors' understanding of the underlying trends in our business. As you know, the company's results can be significantly affected by the currency fluctuations between the US dollar and the South African rand.

I would now like to turn it over to Chris Meyer, Group CEO.

Christopher Guy Butt Meyer
Chief Executive Officer & Director, Lesaka Technologies, Inc.

Good morning and welcome to our first quarter 2023 earnings webcast and conference call. Taking a quick look at today's agenda, I'll start with performance highlights for the first quarter of 2023 and then provide a brief business overview. Steve will provide an update on our merchant business.

Steve will provide an updates on our merchant business. Lincoln will provide an update on the consumer business and Naeem will present details of our financial performance for the three months ended September 30, 2022. I will then conclude the results presentation with our outlook for Lesaka before we open up for Q&A where we would welcome any questions you may have.

First, let me say that Q1 FY 2023 marks the start of our first full quarter as Lesaka incorporating the Connect Group. And I'm pleased to report that execution on our strategic imperatives has translated into solid financial performance, including strong revenue growth and improved profitability. We are delivering on our objectives and we are well positioned to continue doing so.

We have significantly expanded our merchant offering through the transformative acquisition of the Connect Group, which brings together two businesses with complementary product and customer sets. This is a growth story. Connect fills the gaps in our MSME offering and completes the end-to-end financial ecosystem that underpins Lesaka's mission.

On a stand-alone basis, Connect continues to perform ahead of expectations and the strong underlying fundamentals that underpin the business remain intact. Integrating our pre-existing merchant businesses and Connect has been very encouraging and the synergistic benefits have exceeded our initial expectations. The organic turnaround of the consumer business continues to deliver improved performance and remains on track to reach a monthly breakeven adjusted EBITDA during the second quarter of fiscal 2023.

As such, our Merchant and Consumer businesses are both very well positioned to scale and grow in their respective target markets. While at the same time benefit from the synergies and opportunities created by dual-sided ecosystem.

Turning to our funding and capital structure. We have previously highlighted that as part of the Connect acquisition we took on a bridge of ZAR 1.1 billion maturing in April 2024. And I'm pleased to update the market that we are in the final stages of agreeing a conversion of this facility into a three-year term loan, therefore bring greater flexibility, increased liquidity and sufficient capacity for us to deliver on our guidance and growth plans over the medium term. And once in place, this facility provides real evidence of the progress made in the turnaround of our consumer business and the strong ongoing performance of the Connect Group.

So, as you know, in early September, we provided forward earnings guidance for the first time since the transformation and repositioning of Lesaka. This was a bit of a milestone for us as it further illustrates the progress we've made and the clarity we are building in our business.

Our guidance was for revenue to be in the range of ZAR 2.015 billion to ZAR 2.062 billion for FY 2023 Q1. And we are pleased to be able to report revenue of ZAR 2.1 billion, which exceeds the upper end of our guidance. We also guided for group segment adjusted EBITDA to be in the range of ZAR 106 million to ZAR 212 million for Q1 FY 2023. And we have delivered ZAR 111 million in group segment adjusted EBITDA for the quarter, which is at the upper end of the guidance provided, and is a significant improvement on the loss of a ZAR 106 million in Q1 2022.

Revenue growth was driven predominantly by the inclusion of the Connect Group for the full quarter with the momentum in the Connect business continuing, and, as I've said, the drivers underpinning the growth remaining intact. The consumer business continues to deliver an improved performance, evidencing the positive turnaround, and it remains on track to reach breakeven during the second quarter of fiscal 2023.

Along with the primary focus on rightsizing the business, the net active account base grew by 3% in the quarter with transaction volumes and revenue remaining in line. This is testament to the consumer team's ability to grow and serve our client base while at the same time managing a fundamental transformation of our consumer distribution model.

The consumer business reported revenue for the quarter of ZAR 257 million. Segment adjusted consumer EBITDA improved through a reduced loss of ZAR 24 million for the quarter, compared to a loss of ZAR 137 million in Q1 2022. And this improved profitability was driven by a combination of realized cost savings as a result of Project Spring, together with the margin improvement in revenues.

We have previously provided a detailed strategic overview of Lesaka in each of the last three result presentations, and therefore, I intend to only touch on this briefly today. As Lesaka, we strive to improve people's lives by bringing financial inclusion to South Africa's underserved consumers and by helping small businesses access the financial services they need to prosper.

We are constantly innovating so as to help merchants grow, manage, and digitize their business while enabling our large consumer customer base to easily access their money and the financial services they need in their daily lives.

And as we've previously pointed out, there are real challenges to delivering financial inclusion and digitization in the South African market. The challenges stem from a deep distrust in and a lack of understanding of cash alternatives, which is driven by low levels of financial literacy in our country. And adding to this challenge are the relatively high connectivity costs in South Africa. Airtime and data are expensive and prized commodities.

As smartphone penetration remains relatively low, with many South Africans still use oldest style feature phones. And taken together, this all means that although over 80% of South Africans may have a bank account, many treat them as post boxes, withdrawing their money in one transaction. And solving these issues for our customers is our mission. And we have shown that Lesaka is very well-placed to meet those challenges and deliver for our customers.

Lesaka's addressable market is large and it offers multiple levers for expansion. Our platform serves micro and small merchants together with the consumers who would typically shop in their stores. We estimate it would be approximately 1.4 million informal merchants and approximately 700,000 formal merchants in our target market, along with the approximately 26 million consumers in LSMs 1 to 6. With [indiscernible] 00:09:25 target addressable market in the consumer division.

Our strategy is to build our ecosystem where our consumers are. And this often means in the townships and the rural areas of South Africa, creating points of presence that are convenient and accessible for our customers. As such, we have over 68,000 points of presence in the form of branches, retailer pay points, ATMs, satellite kiosks and merchant devices.

This compares to approximately 58,000 disclosed previously.

The Lesaka platform offers growth and broader reach in an underpenetrated market. And we believe there is tremendous scope for both our merchant and consumer businesses to grow and scale in their respective target markets in their own right, while at the same time also benefiting from the synergies and opportunities created by the dual sided ecosystem and self-reinforcing business model we are building as part of Lesaka's value proposition.

As post-COVID travel has started to open up again, we have been fortunate in recent times to host a number of investor visits showcasing the Lesaka platform and allowing our investors to gain firsthand experience of our merchant to consumer offering. One thing that has become evident through these visits is that our offering and growth potential in the formal sector seems to be well understood. However, it is often seeing the size and scale of the informal sector together with our leading offering therein that is invaluable to our investor base and allows them to conceptualize the growth opportunity and the need for financial inclusion in our country. And as such, I thought it would be useful to spend a little more time looking at the informal sector as part of today's presentation.

So, South Africa's informal economy is highly cash-driven. And while information is imperfect, estimates are that the GDP of the informal sector is well above ZAR 300 billion and it continues to grow. We estimate 60% of total transactions in South Africa are cash-based. We also estimate that approximately 90% of transactions in South Africa's informal economy are cash-based.

Anecdotal evidence is that over 70% of fresh fruits and vegetables in South Africa are sold in the informal economy. And so, it is highly evident that the size and nature of South Africa's cash-driven informal economy, necessitates financial inclusion and digitization in the informal market. And it is through our ability to efficiently digitize the last mile of financial inclusion providing a full service fintech platform across cash and digital serving the needs of both, while also facilitating the secular shift to digital that is currently taking place that positions us so well to deliver on our mission.

And with that, I'd like to turn over to Steve to provide an update on the merchant business, as well as progress made on the integration of the Connect Group.

Steven J. Heilbron

Chief Executive Officer-Connect Group & Director, Lesaka Technologies, Inc.

Thank you, Chris. At the outset, let me reiterate that the Connect acquisition was an essential building block in expanding and transforming Lesaka's merchant offering to what it is today. It has served the purpose of introducing new products, services, and customers while establishing Lesaka as a leading player in South Africa's merchant sector.

Getting straight into the financial performance of the merchant division, for Q1 2023, the merchant business reported total revenue of ZAR 1.9 billion, driven by the inclusion of Connect Group for the full quarter from July 01 to September 30, 2022. This compares to ZAR 1.6 billion in the prior quarter Q4 2020, a quarter in which Connect was included for most of the quarter. Similarly, segment adjusted EBITDA for the merchant business increased to ZAR 134.5 million compared to ZAR 124.4 million in Q4 2022.

In Connect, throughput is one of the fundamental measures of how the business is performing and it supports ongoing growth. Compared to Q1 2022, Kazang's cumulative transactional throughput grew 29% to ZAR 5.8 billion. This continued momentum demonstrates the value that we bring to our informal merchants through this offering. I will go into more detail on this when I talk to operational metrics.

We saw robust growth in our Cash Connect business, with cash settlements up 19% to ZAR 27.5 billion, despite the challenging environment for retailers over this period. In Connect's card acquiring business, cumulative transactional throughput continued its exceptional growth of 115% to ZAR 2.3 billion due to further traction in penetrating the informal market through Kazang Pay. As indicated previously, we believe there to be a strong growth potential in this product.

Finally, we saw great traction in Capital Connect, which focuses on providing merchants quick access to working capital, disbursing approximately ZAR 190 million in Q1 2023, up 77% compared to Q1 2022. We previously mentioned that we anticipate strong growth in this arena, which certainly has been the case with two record lending months in the first quarter of 2023. We're also seeing good momentum in Kazang Pay Advance, which was launched a year ago off the back of Kazang Pay in the informal market.

Now, in our EasyPay business, as expected, we see a decrease in best value processed for prepaid electricity as a result of load shedding. It's important to clarify that this decrease is not due to a loss of customers.

VAS value processed for prepaid airtime increased by 8% and our bill payment volumes declined by 2%. We remain focused on the repositioning of our EasyPay business and on prioritizing commercial revenue streams in relation to existing and new clients.

In [indiscernible] 00:16:06 our point-of-sale terminal business, revenue generated from the sale of point-of-sale devices can be lumpy given the seasonality of vault sales. We have, therefore, reflected a 12-month rolling average and will do so going forward for Q1 2023 compared to Q1 2022. This being a more meaningful metric in tracking the performance of this business. The 12-month rolling average for FY 2023 Q1 was 7,761 terminals sold compared to 3,365 terminals in the first quarter of 2022.

We are excited about many of the opportunities in our merchant business. Lesaka today has a comprehensive offering to SME merchants in Southern Africa and now has a distinct, dual-sided ecosystem driving financial inclusion and serving both merchants and consumers.

As Chris mentioned, the integration work between the preexisting merchant business and connect has been extremely encouraging, and synergies to-date have exceeded the expectations that we had going into the acquisition.

Our vault business effectively puts the bank in approximately 4,200 merchant stores. Historically, we've been placing our vaults into formal SME merchant stores, but are now also penetrating the informal sector under the Kazang Connect Vault Grant. This has provided significant operational. This has provided significant operational and risk benefits for our Kazang informal merchant base.

We are also pleased with the progress made in integrating Lesaka's ATM business into Cash Connect and the beginning, the rollout of our new ATMs and recyclers as part of a holistic cash management solution. This is in pilot phase. What we envisage here is an ATM product that is a cash vault with cash dispensing capability. This integration will also increase traffic across Lesaka's because ATM infrastructure.

In our card acquiring business, we saw excellent growth during the quarter with more than 5,000 new merchants being added. We extended our offering into the informal space last year and in the Kazang pay, and the pace of growth continues to exceed expectations. This is a profitable revenue stream as we leverage our existing infrastructure to grow this offering, a clear competitive advantage in the space.

Growth was supported by broadening our product set for merchants, enhancing functionality and corporate partnerships. Card enabled point of sale devices is up more than 100% from a year ago, with approximately 27,700 card devices deployed at the end of Q1 2023. The card acquiring opportunity in the informal market is nascent, and a large portion of this market is still to be captured.

In our VAS and bill payments business, we added approximately 6,300 merchants in the quarter ending Q1 2023, with approximately 57,000 devices in the field. This was driven by organic customer acquisition and also supported by corporate partnership initiatives. The EasyPay money market pilot is proceeding according to plan, and we are very pleased at the swift pace in which this initiative has been implemented.

All basic vending functionality, including ticketing, has been completed, and has been installed at numerous pilot sites. The outcome in these pilot sites are materially larger than in the informal sector, rolling out more easy pay money market offers an exciting growth opportunity and is a significant synergy of the Connect acquisition.

This slide is an example of the partnership initiatives that continue to support growth by positively impacting customer acquisition and operational efficiencies as well as improving value for our merchants. This image is twofold, highlighting that a merchant can take card payments from his customers at this tavern via Kazang Pay, and the merchant can also sell a bouquet of various products to consumers of the same device for cash or card tender. At the same platform, the merchant is able to settle South African Breweries AB InBev for stock purchases directly from his e-wallet as opposed to making cash payments for stock.

In conclusion then, we are incredibly pleased with what has been delivered in the Merchant business. The Connect business has continued to grow in line with expectations and in sync with historical achievements, and the team has executed on new growth initiatives in a short timeframe. This is certainly the early stage of what is potentially a large growth opportunity.

I would now like to hand over to Lincoln, CEO-Southern Africa, to discuss the Consumer business.

Lincoln Mali

Chief Executive Officer-Southern Africa & Director, Lesaka Technologies, Inc.

Thank you, Steve. Good day, everyone. Moving on to our Consumer segment. In the first quarter of 2023, we continued to make great progress on rightsizing the business towards implementing our revised consumer strategy focused on product and efficient distribution channels.

First, let me remind everyone that on the Consumer side, we currently provide transactional banking, short term loans, a digital wallet, as well as insurance and various value-added services to underserved consumers underserviced consumers in South Africa. This is aligned with our purpose of improving people's lives and the increasing financial inclusion.

At the end of September 30, 2022, we grew our customer base by 15% to 1.17 million active EPE transaction accounts. [indiscernible] 00:21:57 in our EPE banking offering is evident with the number of issuer transactions being any transaction resulting in revenue earned is up 75% to 2.3 million transactions in this quarter.

We ended the quarter with 267,000 active policyholders, up 10% compared to a year ago in our EasyPay insurance product offering, which we previously called SmartLife. Our insurance business has a very high cash collection rate of 98%, and this has remained consistent over many years. Our loan book size in our EasyPay loans, previously branded Moneyline, was ZAR 351 million at the end of September 30, 2022. This portfolio comprises approximately 190,000 loans and there's a loan ratio of less than 4% per year. Our loan loss rate and the high cash collection rate in insurance emphasizes our compelling value proposition in offering fit-for-purpose solutions to millions of consumers desperately needing financial services.

We also see continued improvements in the ATM business with over 3 million transactions through our ATMs in the first quarter of 2023. The productivity of the ATM has increased significantly after implementing our ATM optimization actions. The number of ATMs in the field has decreased by 40% compared to a year ago, and the average number of transactions per ATM is up 60%. I will discuss ATM optimization in more detail when I get to my next slide.

While we have achieved a great deal in our 2022 financial year, from refining our value proposition, repositioning our offering to be more customer-centric, to building a sales culture, I want to remind everyone that we're still early in our transformation journey and there's still a lot of work to be done. We have taken more stringent measures to grow our active EPE consumers, and now with the right team in place, the right products, and having the right size of the business, we will focus our efforts on reaching breakeven in the consumer business by quarter two of this financial year 2023.

Practically, we have focused our efforts into understanding what our customers are looking for, the best channel to engage them with, what our customers – our competitors are offering, and where we can disrupt the space by designing the right innovative products that truly meet our customers' needs. This slide shows how we have reinvented our distribution model.

Following the execution of a full performance review across our branch network, we have closed over 100 branches and commenced the shift into the retailer partnership strategy. Our mindset is to shift from traditional bricks and mortar towards an in-store kiosk wherever possible. We continue to build in-store partnerships with merchants who are both national and independent players, and this brings our consumer proposition to where our customers want to be and drive footfall into the merchant stores. This includes identifying the right retailers to partner with, being the retailers that service our market the grand recipient market. We have streamlined our onboarding processes including tech-enabled mobile sign-ups. These efforts are beginning to yield expected results.

We have made great progress towards implementing our revised consumer strategy focused on product and efficient distribution channels. Our ATM optimization program is also benefiting from the retailer partnership strategy as we've shifted more ATMs out of branches into retailers. We've also deployed almost 40 through the world ATMs. These ATMs are available for more hours, given optimal positioning within the stores or malls accepting more customer footfall. This means increased volumes, especially the number of the [indiscernible] 00:26:24 transactions.

Steve and Chris have already touched on the encouraging results from the launch of our EasyPay money market offering. The image on the bottom left brings to life the EasyPay money market concept, which has been launched in merchant stores. This is a great example of how in practice we've executed on an opportunity to develop the self-reinforcing ecosystem which creates synergy and opportunity for growth and expanding their overall Lesaka value proposition.

In Q1 2023, we achieved approximately 78,000 EPE accounts activations and our churn rate averaged well below 5%, evidencing traction in our focus consumer strategy. As a reminder, churn for us predominantly relates to the impact of the reactivations and deactivations in the SRD grand space.

I think it's important to highlight that we apply a very rigorous approach in our measurement criteria for what we regard is an active accounts. We only classified an account as being active if there was activity on that account during that specific month. Our profitability improved in quarter one 2023 as we reported a reduced segment adjusted EBITDA loss of ZAR 24 million compared to ZAR 137 million in the first quarter of 2022.

The consumer segment adjusted EBITDA loss narrowed further and were very close to breakeven level. As part of our renewed consumer strategy, we'll continue to focus our efforts on attracting permanent grant recipients, growing active accounts, and increasing penetration across our loan book and insurance product. We've seen mixed results with these two product offerings. Insurance sales continue to strongly outperform, while growing the loan book has been slower than expected. And we are very focused on actions to drive awareness of this product.

Despite the challenges in growing the loan book, we remain on track to achieve breakeven by quarter end December 31, 2022. As you can see on this slide, the monthly run rate of the Consumer Business segment adjusted EBITDA loss continues to move in the right direction as we progress on our turnaround strategy for the Consumer business.

I will now hand over to Naeem, our group CFO, to discuss our financial performance.

Naeem E. Kola

Chief Financial Officer, Treasurer, Secretary & Director, Lesaka Technologies, Inc.

Thank you, Lincoln. The first quarter of fiscal 2023 year continue to build on the strong momentum from Q4 2022 for both the Merchant and the Consumer business. We continue to be very pleased with the performance growth of the Merchant business, successfully integrating Connect group into the Merchant business and their continued turnaround and improve consumer performance.

Good performance in revenue, cost reductions and improved EBITDA being reported. We achieved a consolidated group revenue of $125 million for the quarter, compared to $35 million in Q1 2022, mainly related to the revenue for the Connect group consolidated for the full quarter.

Positive turnaround of normalized EBITDA to a profit of $2.8 million for the quarter. It is essential to note that the Q1 2023 includes pre-existing Lesaka and Connect Group for the full quarter compared to Q1 2022. That only includes a pre-existing Lesaka business.

Q1 2023 delivered a positive performance across all the financial performance categories. Thus, we are very enthusiastic about as we transform the business to deliver growth and strong performance results. The merchant business, including Connect Group consolidated, continues a strong – solid strong performance trajectory. While the consumer business turnaround continues in the right direction, growing on account and transaction numbers while reducing and rightsizing the consumer cost base.

Total combined revenue for the quarter was ZAR 2.1 billion, 13% growth compared to Q4 2022, coming from including Connect Group for three months versus 2.5 months in Q4 2022, as well as the continued underlying growth in the revenue drivers. Revenue delivered in the quarter exceeded the upper limit of a guidance in range. We achieved a segment adjusted EBITDA profit of ZAR 111 million as compared to an EBITDA loss of ZAR 106 million in Q1 2022, and a normalized EBITDA profit of ZAR 58 million as compared to an EBITDA loss of $143 million in Q1 2022.

This performance is evident of the significant performance turnaround of the group has achieved

Through the acquisition Connect Group and the cost rightsizing in a consumer business. The segment adjusted EBITDA profit of ZAR 111 million for the quarter came in close to the upper end of the guidance for the quarter in rand.

The merchant business achieved the revenue of ZAR 1.9 billion and the segment adjusted EBITDA profit of ZAR 134 million, a solid performance with continued strong growth across the Connect Group Business. Consumer business delivered a segment adjusted EBITDA loss of ZAR 24 million rand as compared to an EBITDA loss of ZAR 137 million in Q1 2021, ZAR 113 million turnaround driven mainly by cost savings.

I will now take you through the performance on the US dollar converted basis for the quarter, noting that we use an average rate of ZAR 17.13 to the dollar for the quarter compared to ZAR 15.56 used in Q4 2022. This is a 10% devaluation in the rand. The total combined revenue for the quarter was $125 million, with a segment adjusted profit of $6.5 million and a normalized EBITDA profit of $3.4 million.

I will now focus on the components underlying revenue. Revenue increased from $34.5 million to $124.8 million when compared to Q1 2022. Merchant revenue was $109.4 million, contributing 88% of the group's revenue. Revenue increased primarily due to combining Connect Group revenue under the merchant business segment. Telecom products and services includes all the events and bulk payment collection we do across the group. This has increased to $76 million, mainly from the contribution from Kazang.

Processing fees increased to $27 million, mainly from the inclusion of the processing fees and through the cash collect business. Interest from customers represents the revenue earned from merchant advances.

Turning to the Consumer Business segment. At the revenue line, we achieved $15 million of revenue compared to $17 million of revenue in Q1 2022. This was mainly due to the depreciation in the rand to the dollar. On a rand basis, revenue grew by 2%. We continued to achieve consistent growth of account fee revenue, ATM revenue while insurance commission revenue delivered strong growth in this quarter.

At an EBITDA level, the impact of the turnaround continues to be evident with a consistent improvement in EBITDA since the first quarter of fiscal 2021. We achieved ZAR 58 million of normalized EBITDA for the quarter, an increase of 43% as compared to the fourth quarter of 2022. The improvement in the EBITDA is attributable to both the Merchant & Consumer Business segments.

In US dollar terms, this equates to a normalized EBITDA profit of $3.4 million in this quarter, an improvement of $800,000 compared to Q4 2022. Earnings per share both basic and fundamental showed similar trend of positive turnaround since the last – since last year this time in prior quarter. This is indicative of the positive EBITDA contribution from the inclusion of Connect Group which has exceeded the increased interest cost and amortization of intangibles as a result of the acquisition.

Our operational cash flow utilization has decreased from $10 million in Q1 2022 to $0.5 million for Q1 2023. From a cash flow perspective, we continue to make improvements with a reduced reliance on cash reserves to fund operations. This has been achieved through cost reductions and an improved revenue as well as positive cash flow contribution from the Connect Group. Capital expenditure for the quarter was $4.5 million compared to $2.8 million in Q4 2022. The increased CapEx predominantly related to growth CapEx spend on cash recyclers for our ATMs and the point-of-sale devices to support the growth in the Kazang Pay business.

We have a net debt position at the end of the quarter of $104 million. This includes unrestricted cash of $93 million and total debt of $197 million. We continue to focus on creating a stable and long-term capital structure.

We have worked closely with our bankers and have agreed a restructure of the ZAR 1.1 billion rich facility that is subject to final approval by our bankers. The renegotiated position will introduce greater flexibility and further increase liquidity as we invest for growth.

As of the last quarter, we continue to hold our MobiKwik investment at $76 million in line with the last capital raise. Our Cell C investment we continue to hold at zero and [indiscernible] 00:36:30 investment at $5 million. These investments remain as non-core.

Overall, the first quarter of fiscal 2023 is evident of the efforts we have implemented in fiscal 2022 and is now delivering the positive results. Our continued focus on these strategic initiatives is progressing well, and we are optimistic of delivering on positive performance.

I would now like to hand over back to Chris, who will address the group's outlook.

Christopher Guy Butt Meyer

Chief Executive Officer & Director, Lesaka Technologies, Inc.

And so, in closing, we wanted to provide you with guidance on the near-term performance of the group. Although we report results in US dollars and the US GAAP, our operational currency is in South African rand. We analyze our performance in South African rand. And as such, we believe it makes sense to provide our guidance in.

For Q3 2023, Lesaka expects group revenue between ZAR 2 billion and ZAR 2.3 billion for the 3 months ended December 31, 2022. Total segment adjusted EBITDA is expected between ZAR 157 million and ZAR 164 million, comprising Merchant segment adjusted EBITDA between ZAR 145 million and ZAR 150 million, and Consumer segment adjusted EBITDA between ZAR 12 million and ZAR 14 million.

We expect group costs of approximately ZAR 41 million for Q2 FY 2023, which means that this results in an adjusted group EBITDA of between ZAR 116 million and ZAR 123 million for Q2 FY 2023. And for the full financial year FY 2023, we are reaffirming the total group guidance provided on September 19, 2022 on a rand basis.

Our outlook for group revenue is between ZAR 8.7 billion and ZAR 9.3 billion for the 12 months ended June 30, 2023. Total segment adjusted EBITDA is expected between ZAR 645 million and ZAR 675 million, comprising merchant segment adjusted EBITDA between ZAR 550 million and ZAR 565 million, and consumer segment adjusted EBITDA between ZAR 95 million and ZAR 110 million.

Adjusting for group costs, which we expect to be between ZAR 155 million to ZAR 165 million on a normalized basis for FY 2023 implies an adjusted group EBITDA of between ZAR 480 million and ZAR 525 million for financial year 2023.

And with that, we'd like to turn to the Q&A session to answer your questions. Thank you.

QUESTION AND ANSWER SECTION

A

Thank you. We will now start our Q&A session. For those joining us via the webcast, you can ask your question live by raising your hand in Zoom. For those joining the Zoom teleconference line, again, you can now ask your question live. We'll just pause here to assemble the queue. We'll take our first question from Raj Sharma from B. Riley.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Hi. I want to understand the consumer Q2 guidance. In the fiscal 2023 guidance, there's a step change in performance. Can you talk about what's driving this growth? I'm sorry. Can you hear me okay?

Christopher Guy Butt Meyer
Chief Executive Officer & Director, Lesaka Technologies, Inc.

A

We can hear you. Can you hear me? It's Chris speaking.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Yes. Can you talk about what's driving this growth? I'm sorry, can you hear me okay?

A

We can hear you. Can you hear me? It's Chris speaking.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Yes.

A

Hi, Raj. And thank you. Thank you for joining the call. Welcome. We heard the question. I just want to make sure I got it. You spoke about a step change in the second half in the consumer business in terms of the turnaround and just looking for a little bit more color, I'm going to ask Naeem just to address that for you.

Naeem E. Kola
Chief Financial Officer, Treasurer, Secretary & Director, Lesaka Technologies, Inc.

A

Hi, Raj, how are you doing? Hope you're well. So, Raj, if you look at the Q1 results and what I've highlighted in my presentation is in September, we closed the consumer business with just under a ZAR 2 million loss.

Now, a large part of that turnaround has come through from the cost savings as well as the increased revenue. If you look at the Q2 forecast that we've provided of ZAR 14 million, around 60% of the turnaround will come through from some of the cost savings that we've already executed on. And it's merely a timing of those cost savings coming through. And about 40% of that will come through from our revenue uplift.

So, as we've noted and Lincoln has highlighted, as we deploy our ATMs, we're looking at higher revenues coming through from our ATMs, as well as our loan businesses. We only have quite a bumper month in the month of December, where we'll have a higher performance on the loan book as well. So, you know, those two are the two critical areas that will really drive the Q2 turnaround for us. And if you take that on a full year basis, around 56% of the uplift will come through from the cost savings. The additional cost savings, in addition to the Project Spring, and around 44%, 45% will come through from additional revenue.

So, that's, again, building on the revenue run rate, mainly from the ATM rollout in the across the markets in the retail segment and from the money line book growing.

A

Raj, any additional questions?

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Yes. Thank you. And then, can we talk of the consumer business a little your EPE account activations have up on a monthly basis. It seems like they're at 78,000 run rate. Do you anticipate, you know, this rate to sort of continue over the next year? Is it too early to talk about some long-term trends here? And are you still targeting the 45%, 50% sort of monthly activation rates? Could you comment on that, please?

A

Sure. Okay. Thanks, [ph] Raj 00:43:59. I think, so, the momentum we see and the growth rate we're seeing on a net basis in terms of active account. So, net of churn. When we look forward, we essentially assume that sort of momentum that kind of growth rate will continue.

So that's how we, you know, plan and forecast within the business. And so, that we're looking at current quarter and using that as the basis. That said, you know, we've said this before, it still is early days for us. We still have a number of initiatives out there with our team in terms of improving a lot of the tools of trade for our sales staff.

Lincoln spoke about the rollout of the digital [ph] iPad 00:44:55 onboarding device that makes life a lot easier. A lot of time and effort spent on training of our staff, you know. The shifting of our branches into the retailer. All these things are additive in terms of, you know, helping us grow the account base. And, you know, you should see benefits in the future. But ultimately, the way we've tried to plan and forecast looking forward is based on what we're seeing at the moment.

A

If I could just add one more thing, Raj, is we've also got the staff to focus much more on permanent grant recipients because the other grants are quite volatile, which are the SRD grants. So, people can get a grant today and then they don't qualify the next month. So, the permanent grants are the ones that give us much more certainty and we focus much more on activating those accounts and making sure that our staff is actually zeroing in on activating permanent grants because that gives us much more certainty and that gives us much more of a better runway and it allows us to cross-sell the other product as well.

A

And Raj, any other questions?

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

One more question then I'll maybe get back in line. The consumer is – staying on the consumer, revenue saw benefit from higher insurance. Is this – and you said that the loan book was tougher to sort of grow. Can you talk about what's driving this or – and how are you driving the higher insurance?

A

Yeah. If you go back to – yeah. Thanks, Raj. If you go back to our earlier conversations, you would remember that we indicated that many of our staff could only sell one product and there was not enough product knowledge of all of our products.

Now getting all of our staff to be trained and to be accredited to sell all of our products has now really helped. And also enhancing our product has also helped the Smart One project that we launched so the combination of those two things is helping the growth in the insurance space. So, getting our staff trained, making sure that they've got the right product, and we're starting to see more clients visiting us as we're getting our ATMs in the right spaces, all of those things are contributing to what you're starting to see.

A

Great. Thank you, Raj. Next, we'll take [ph] Jed Trapagan from Plow Penny 00:47:46. Jed you may ask your question. Jed, you may need to unmute your line to ask your question.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Hi. Sorry about that. Can you hear me?

A

Yes, Jed. Thank you.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Sorry about that. Thank you for taking my call. Do you still have an active stock buyback program in place? And if so, how large is that? How much has been used?

Christopher Guy Butt Meyer
Chief Executive Officer & Director, Lesaka Technologies, Inc.

A

Hi. It's Chris speaking. I hope you can hear me. So, we do have a some capacity for buyback. We'd have to get back to you on the exact capacity. I don't have the numbers to hand, but there is some capacity for buyback. I think if your question is, what is our view on buyback, I think at the moment for us, our focus has been on investing funds into the business, reducing the cash burn and the losses, getting this business into a cash positive position.

So, you know, we would – you know, we're always looking in the market. We believe a buyback is a, obviously, a positive sign to the market. But, you know, for where we are at the moment, you know, we are somewhat constrained on our cash resources and focused on investing in the business. That's not to say that we're not watching it and that under the right circumstances we consider it.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Okay. Great. Thank you. Another quick question. A few months ago, you had filed a shelf with the SEC. Are you – inferring, you were contemplating an equity financing. Any update on that? Do you foresee that being required?

A

[ph] Ted, 00:49:57 so the filing of that shelf, which was in September, early September for us, was very much a business as usual renewal of an existing shelf. So we have a shelf that's there that facilitates equity issue. And every three years, we are required to renew it. And it so happens that the renewal happened in early September.

But just to be very clear, we – at the time and at that time and right now we said we didn't have any plans and don't have any plans to raise equity to fund the existing business or the activity within our business as it currently stands.

I think Naeem was making some very important points earlier around, you know, the restructuring of our existing debt facilities, which we're very pleased about. We are in the final term sheet – with term sheet that final approval that are pending. So we're confident that that will be in place, but it gives us a lot of flexibility. It gives us plenty of runway. And it would be sufficient for us to deliver on the guidance that we've given you and the growth plans that we have for our business.

So we think from a funding there that we have for our business so we think from a funding and liquidity perspective, you know, the resources and the capital structure we have right now are what we need to – in order to deliver for our shareholders.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Okay. Great. Thanks. One last quick question. How should we think about capital expenditures on an ongoing basis? What do you think a good run rate should be for our modeling?

A

[indiscernible] 00:51:38.

A

Yeah. Sure. So, [indiscernible] 00:51:41 you'll see that, you know, [indiscernible] 00:51:43 over this quarter we reported as [indiscernible] 00:51:46 about $4.5 million. I think the way to look at our capital is that we are very focused that our capital is being utilized more for growth capital. So, this spend that we had this quarter has been predominantly on two items, which has been mainly the ATMs.

So we've invested in new ATMs, which are the recycler ATMs, which is part of our retail strategy of aligning with our cash business and giving our merchants ability to have recycler ATMs. So there was quite a bit of investment in the recycled ATMs. And then you'd also see, as Steve highlighted, is that we had significant growth in our [indiscernible] 00:52:27 pay, the merchant acquiring side of the business. So our investment in our POS has also been quite significant this quarter and it's really been underlined by the revenue growth that you've seen come through.

Now, the way I'd look at that, you know, our CapEx spends would be in the range of about $3 million to $3.5 million per quarter going forward. And anything above that would be really justified through higher revenue growth that we see in the Merchant business.

A

Let me underline that a little bit for you, [indiscernible] 00:52:58. I think the key point is that our CapEx investment is growth driven. That's the point. You know, and so we invest in new POS devices, new vaults, etcetera, in order to continue to grow our customer base.

So, as the name says, it's given you a decent run rate that could probably be indicative of the expected growth that we see in our business. If we see – if growth in excess of that, obviously we'd be looking to – that would necessitate additional CapEx in terms of new POS device and new equipment, etcetera.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Okay. Thanks. That's all I have.

Operator: Thank you, Chad. I will now read a Q&A from the panel. So, first from Jarred Houston from All Weather, please provide more detail on the working capital absorption in the quarter.

A

Okay. I'll touch on that. So, look, I think, in our working capital for the quarter, and, again, this touches back onto what Steve had highlighted as part of his presentation, we've seen significant growth in our finance – merchant finance loans. Now, that – the merchant finance loans are typically between three- to six-month loans and are basically reported under our working capital line. So, that is – that accounted for at least about 70% of the increase in our working capital. And just to be clear on that, that is actually funded through a financing facility that we have with – or very specifically for the capital loan book growth rather than from the operating cash flows. So, that's one part of that.

And the other thing that we've seen, which is also in our Kazang merchant business, was mainly related to the merchant funding on the wallet. So, what we did see in the month of September was, because it was close to the end of the week and typically merchants fund their wallets for the weekend, we've seen quite an uplift coming through in terms of the funding on the merchants' wallets in terms of – or advancing for the prepaid services that they offer.

So, there was a slight spike, I would say, of about 20% that it come through that will be above our normal working capital, and then the remainder of that really came through from financing the loan book, which is revenue driven and is a separate bucket of funding.

A

Thank you, Naeem. Next, we have a hand raised from Frank Geng from Briarwood Chase. Frank, you may ask your question.

Frank Geng

Q

Hi there. Thanks for taking my question. Yeah, I just wanted to ask, you know, maybe on the full-year guidance, I just sort of saw relative to the September statement, you know, the Consumer segment contribution was decreased a bit, whereas the Merchant contribution was increased, whereas sort of the overall, as you said, the guidance was reaffirmed. Just curious if you could help walk us through the rationale between that switch.

Christopher Guy Butt Meyer
Chief Executive Officer & Director, Lesaka Technologies, Inc.

A

Thank you, Frank. I'm going to ask Naeem again to pick up on that.

Naeem E. Kola
Chief Financial Officer, Treasurer, Secretary & Director, Lesaka Technologies, Inc.

A

Yea. Look, Frank, so, look, in September, we provided guidance, which was largely based on our budgets. And obviously going through the first quarter, we've reassessed our guidance. And what you clearly see is that our Merchant business has had a stronger performance, and we've been slightly challenge on the consumer side of the business mainly really coming from very clearly identified cost initiatives, but we've been slightly delayed in the execution of those.

As I've mentioned, a lot of that has already been bedded down. It's now the timing of those coming through. And I think also on the loan book, on the Consumer growth, that has taken slightly longer to be able to achieve that, whereas they're still quite focused and got very specific strategies to be able to grow that loan book.

So, what you'll see is that prior year, about 80% of our guidance came from the – of the EBITDA guidance came from the merchant side and about 20% of that came from the consumer side of the business. That is now slightly been adjusted to about 85% coming from the merchant side, really underlying the growth that we're seeing coming through on our – from the Connect side of the business in the present day, and about 15% coming through from the consumer business. Again, we've had to slightly drop some of the forecast that we had in terms of the loan book that is driven some of the change.

A

Thank you. If I could add one thing. Maybe this was just to frame it a little bit. I think in Naeem's earlier comments, the delivery of that – of that guidance for the consumer business is around 55% of it. I think [indiscernible] 00:58:00 Naeem is [indiscernible] 00:58:02 with the cost initiatives that we've executed. And those have all largely been executed upon. In other words, the actions have been taken and those costs should therefore come through.

So, that's quite an important consideration that the 45%, the remainder of the EBITDA contribution in that consumer business is from that mix of revenue growth between our loan book and our transactional activities ATMs, etcetera. So just to give you a feel for how we see it coming through.

Frank Geng

Q

Got it.

Operator: And anymore question? Go ahead.

Q

No, that's about from me. Just very quickly, back on the working capital. If similar to CapEx, is there a way to think about what's a good normalized run rate level of sort of working capital investment that we can think about?

A

Yeah. Look, I think, again, just touching on if I exclude the finance loan book growth, I think, our position on the working capital is that we would be funding – if I talk dollar terms, I think it could swing anywhere between $3 million on the negative side to about $5 million on the positive side.

And again, it really depends on when the month end is. Because if we are on a Monday, we typically loan cash; whereas if it happens on the weekend, we tend to fund our merchant side because of the fact that they go through the weekend and there are some advances on their wallets. So, that would be the fluctuation between, I would say, a negative $2 million to basically a positive $3 million to $5 million. And that excludes the finance on the merchant book. I think we're seeing very good growth on the finance of the merchant book which is really driving some of the growth on the revenue side. But again, that's finance funded outside of our operating cash flow.

So, from a disclosure perspective, we've got pull it on our working capital, but I would look at that as a separate bucket.

Q

Got it. Very helpful. Thank you.

A

Great. Thank you. We will pause here to see if there are any more questions. And we have a followup from Raj.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Hi. Yeah. If I can ask just a more philosophical, a bigger-picture question. Some people struggle with your business model. It's not going to be eaten up by a bank or a large entity. Why would people need to use your card versus just getting a bank card, right?

A

Raj, so, thank you. I think we do get that question. And there are a few things here to consider. So, first and foremost, our focus in our business is very much on the lower LSMs in Connect Group in South Africa. And the merchants who serve those consumers as individuals. And a large proportion of those people and the merchants that see them are in this informal sector, which is largely unpenetrated, as we've explained. And although, you know, 80% of the people [ph] marked 01:01:40 really have a bank card with one of the other banks they're treating that bank card or that bank account as a postbox, withdrawing all of their money in one hit and removing that and operating in the cash environment.

So, our card you know is what we're wanting to build around that card is that bouquet of offering. We are creating our presence where our consumers or where our customers are. And that's through the partnering with the retailers that we explained and building our points of presence where it's convenient and accessible to our customer base. Our focus of is so much more so on this informal market and the grant recipients space. That's our – that's front and center for who we are.

And so, we believe we're providing a transparent, simple product for that consumer and then bringing it together with the merchant proposition and starting to build that ecosystem that would encourage our consumer to operate and transact within the merchant store by providing, you know, rewards and incentives to do so. We talk about that self-reinforcing ecosystem. You know, this is – this will be the reason for a consumer to want to try [indiscernible] 01:03:04 operate within our ecosystem.

So, you know we have a very clear proposition. We have a very clear focus on who our customer is. You can see through the volumes coming through our points of sale with our merchants that more and more we are seeing take up of digital of card payment. The growth in card acquiring in the KazangPay underlines that. And so, yeah, we have a very, very clear proposition.

I think the market has been historically and is very cash-oriented, as we've said. And the banks have not been able to translate that historically. We are seeing progress in our business model and really driving that digitization that we speak about. So, I think the proof is in the pudding at the end of the day.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

You know, does this – it doesn't stop the banks from going after this space, right. As they run out of growth, does that – you know, do the banks then start to focus on your market? I get that you've disrupted the market, but how much of a lead or a first mover advantage do you have in the local economy?

A

Thanks, Rajiv. I'm going to invite Steve to answer the question. He's been sitting quietly on my left. So, I think it's a good segue to bring Steve into the conversation.

Steven J. Heilbron
Chief Executive Officer-Connect Group & Director, Lesaka Technologies, Inc.

A

Cool. But I mean just for clarity, I think that question was directed at the – specifically to the consumer or is the question around merchant?

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Well, really, I mean, consumer and merchant, right, you have disrupted the business or are making inroads. What stops the banks from going after the space? They run out of growth in their usual areas. Why wouldn't they come after this space?

A

Sure. But let me just make a few comments if I can. So for starters, if you look at the consumer space, the reality is we're sitting at in the region of 1.1 million accounts. The universe of growing customers is, Chris correct me, I don't want to quote a number the total universe is I mean, South Africa has 12 billion bond customers.

A

It's around 12 million what we would call permanent bond customers. And of that, there are about 6.5 or so that are customers of the Post Office or the Postbank.

A

Yeah. So, the line size of that consumer base is sitting with the Postbank. And so the reality is we're still a relative minnow in that space and I think there's substantial room for us to grow. And if the big four banks decide that this is an area that they want to focus on, there's probably room for them to make an entre in that space as well but let's just be quite clear. We certainly are not dominant in that space and we have a very compelling product offering.

And there's plenty of room for us to – for us to increase our market share. We certainly are not the incumbent in that space as it stands right now. From a merchant perspective, again, I see nothing but opportunity. The reality is we have a very, very – if you look at the formal segment, we have a – a slid of the formal market, so, so the opportunity – if we make a tiny dent in – from a fintech perspective in a call streams of cash acquiring, card acquiring credits and the likes, then, you know, that's all – that's all growth for us.

If you, sorry, if you could excuse me 1 second. Sorry, can you give me 1 second. Let's pick – pick it up for you to see that, okay. So, I think the point Steve was trying to make on the merchant side is, you know, we have already proven that we've got a, you know, a strong distribution base. We have got, you know, over 60,000 devices with, you know, in – through Kazang in the informal sector. And we have – we have built that footprint out there, and we're seeing growth, you know, on all fronts.

So, but the point being that, you know, I said it – said earlier that we see around 1.4 million informal merchants in our space. And so, our, you know, our market share at this point is small. It's less than 5%. And I think that's the point Steve's trying to – was trying to make, which is, you know, we see opportunity, we see growth, and we operate, we feel we're coming from a position of great momentum because we've already, you know, started to build that, that distribution base. And month-on-month, you know, adding our customer base, our merchant customer base and rolling out those devices.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Great. Right.

A

You heard [indiscernible] 01:08:37 but. Yeah.

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

I don't know if you guys can hear me. Can you hear me?

A

Yeah.

A

Yeah.

A

I think we answered the rest of the question for you, Steve. I don't know if, Raj, if that is sufficient?

Rajiv Sharma
Analyst, B. Riley Securities, Inc.

Q

Yeah. We're – we are good on that. Thank you. And thank you for answering question. I'll take – I'll take my questions offline.

Dara Dierks
Managing Director, ICR LLC

A

Thank you, Raj. And that is all the time we have for questions today. You are welcome to reach out to management if any questions remain unanswered. I would now like to turn the call over to Chris for any closing remarks.

Christopher Guy Butt Meyer

Chief Executive Officer & Director, Lesaka Technologies, Inc.

Thank you, Dara.

I think just all that remains is just to say thank you to everybody for joining the call. Thank you for listening to our presentation today, and a big thank you for the questions. I think that is really indicative of the interest in our business. Good questions, substantive questions, questions on the momentum that's in the business and the progress that we've made so far. I think that the sort of the closing remark would be our focus is on delivery.

Our focus is on delivery across the business, and we've got a lot going on. We're really excited about where our business is at the moment. You've seen the guidance that we've given for the next quarter, and it's all about delivering to that. And we look forward to speaking to you all again in three months' time.

So, from – on behalf of the team, thank you very much and goodbye. Thank you.