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# Valuation as a risk

Evan Lorenz writes:

Rumors that the Department of Justice has Nvidia Corp. in its antitrust crosshairs was the supposed cause of the 9.5% nosedive in the shares of the most important company in the world two Tuesdays ago. But why did the other 499 stocks in the S&P 500 simultaneously fall out of bed?

Maybe price has something to do with it. Labor Day found the S&P 500 "almost as pricey as it was at the January 2022 bull market top," the commentator Mark Hulbert observes in a recent MarketWatch column. Indeed, on the bases of price-to-forward earnings and price-to-book ratios and in relation to broad money supply, the index was its most overextended since 2000, a period that encompasses both the dot-com bubble and the everything bubble.

Which brings us to Samsara, Inc. (IOT on the New York Stock Exchange), a software-as-a-service company that trades at more than 20 times sales—sales, mind you—and faces slowing growth and rising competition, besides. In preview, we are not bullish.

In 2006, a pair of graduate students at the Massachusetts Institute of Technology, Sanjit Biswas and John Bicket, parlayed their networking research into a startup called Meraki. Six years later, Cisco Systems, Inc. purchased their brainchild—which made Wi-Fi equipment for small and medium businesses that could easily be managed in the cloud—for $1.2 billion.

The duo spent two years integrating Meraki into Cisco before going off in search of the next big idea. In 2015, they founded Samsara (a word, in Hinduism, according to Wikipedia, connoting the cycle of life, death and rebirth) and at length identified an opportunity in commercial trucking. A new federal regulatory mandate was the catalyzing agent.

The government had had little success keeping drowsy truckers off the road when those nodding operators self-reported their hours of work on the honor system with paper logbooks. Late in 2017, the Federal Motor Carrier Safety Administration mandated an upgrade to electronic logging devices (ELDs). Now the technology produces a reliable record of hours worked and routes driven. To executives who had previously managed their fleets with logbooks and phone calls, it was a boon. "Telematics" is the generic name for this budding branch of information technology.

To the mandated ELD requirements, Samsara added monitoring for screeching brakes, sudden accelerations and crashes. Its telematics suites are available for purchase for three or five years at rates of around $30 per truck per month. Samsara, not the customer, pays for the hardware, at a cost of approximately one-fifth of Samsara's revenue over a five-year contract. According to research firm IDC, telematics can deliver a 20% decrease in idling time, a 10% uplift in vehicle lifespans and a 29% decline in accidents. It adds up to an eightfold return on a truck operator's purchase price, or so says the analysis, which Samsara commissioned.

What Samsara does not provide is an exact breakout of its products by revenue. Telematic systems account for around 45% of the top line. "Video-based safety" cameras, mounted inside and outside the truck to prevent crashes and to flag texting while driving, deliver another 45%, leaving 10% for such miscellany as software applications that automate clerical chores and monitor employee compliance with training modules.

Samsara heralds its camera feeds as the salvation for drivers who, without those prying eyes, might be saddled with punitively high insurance costs stemming from the fictitious accident claims that unscrupulous motorists file against them. "We've been able to exonerate, if not dozens, hundreds of drivers," Fred Matthews, a senior project manager at DHL, attested at Samsara's investor conference on June 27. "And that's in part to Samsara, because now we got their back, right? We're protecting them."

Yet not every driver is keen to sit under the unblinking gaze of a remorseless digital Karen. "Yesterday was the last straw," a visitor to the Reddit, Inc. forum AmazonDSPDrivers complained two weeks ago. "I quit after my route last night. Why? At the morning safety briefing, we go through all the normal 'remember to stop at stop signs' stuff, then they tell us 'Amazon is trying to really cut down on distracted driving, so we can't be singing along to the radio because the camera will ding you for distracted driving.' When people understandably started getting upset, we were told that 'a lot of mouth movement will set off the camera' and that we 'needed to keep mouth movement to a minimum.'"

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Though the Samsara front office is a heavy net seller of Samsara common stock (see below), the executives can still spin a bullish story. Thus, declared CFO Dominic Phillips at a June investor event, "we're operating in really

**Think again, Mr. Market**


source: The Bloomberg

large markets that are very underserved by technology." He estimated that the size of the "total addressable market" for telematics and video-safety products was as high as $51 billion last year and could grow to $99 billion by 2026. Add in equipment tracking to Samsara's other workplace apps, and the company sees a $200 billion sales opportunity within two years. It would be quite an improvement from Samsara's current 12-month revenue run rate of a little more than $1 billion.

Less than "50% of all commercial vehicles in North America are using a vehicle telematics solution today," Phillips continued, and only 10% deploy those prying video eyes. Because Europe does not mandate telematics, penetration rates on the Old Continent are lower than they are in the 50 states, which delivered 87% of the company's second-quarter sales.

Revenue growth subsided to 37% in the three months ended Aug. 3 from 108.5% in the fiscal year ended Jan. 30, 2021, but Samsara regards the downshift as nothing worse than a lull. New products and the prospects for foreign growth promise a long horizon of continued double-digit expansion.

Artificial intelligence, of course, will contribute its mite, the bullish argument continues. Already, AI-enhanced computers can pore over camera feeds to monitor a driver's seatbelt compliance and sound an alarm to head off a threatened accident. An AI assistant in Samsara's software can help pull reports on, say, the list of vehicles in need of servicing and can maximize the efficiency of trucking routes. Nor are prospects for future growth circumscribed by the limits of the trucking market alone. Samsara's asset-tagging products, which use small Bluetooth devices to track locations of inventory, tools and capital goods, promise to reduce losses, increase utilization and streamline maintenance planning.

If all goes according to plan, CEO Biswas told the June confab, Samsara will one day become indispensable. It will occupy the same dominant position in the physical operations of its client companies that Salesforce, Inc. does for customer-relationship management, ServiceNow, Inc. for IT departments and Workday, Inc. for HR. Samsara, said Biswas, will create a "system of record" for the physical operations (vehicle fleets, inventory, CNC lathes, hydraulic presses and just about any other three-dimensional business asset) for its clients.

For which reason, bulls speculate, Samsara may prove less cyclical than the typical software vendor. For one, telematics and asset-tagging tap a customer's operating budget rather than its IT budget (the former being less cyclical than the latter). Highlighting the aforementioned IDC study, CFO Phillips contended that Samsara's telematics platform is a money-saver. "And so even in a situation where there potentially is an economic downturn," said Biswas, "customers may be more motivated to find additional ways to save money, and we can help them do that."

Samsara does all of this inside a software-as-a-service wrapper. In a conventional software transaction, a customer purchases a perpetual license: one and done. To generate more revenue, the vendor must sell his customer a new license, usually with the promise of a must-have upgrade. With SaaS, the customer pays monthly fees for a business-critical service, so fee income is ongoing. To be sure, a customer may choose not to pay, or to unsubscribe, but his departure will cost him access to the application and, frequently, to the data stored therein. It's the predictability and stickiness of the cash flows that explain the sky-high multiples that SaaS companies command in the public markets and why private equity promoters count them as ideal candidates for leveraged buyouts.

Samsara, going on 10 years old, has

## Samsara, Inc. at a glance

**all figures in $ mns except per share data**

| | TTM* | FY2024** | FY2023 | FY2022 | FY2021 |
|---|---|---|---|---|---|
| revenue | $1069.2 | $937.4 | $652.5 | $428.3 | $249.9 |
| operating income | -302.0 | -323.3 | -259.5 | -353.8 | -209.5 |
| net income | -262.5 | -284.5 | -247.4 | -355.0 | -210.2 |
| earnings per share | -0.49 | -0.54 | -0.48 | -1.28 | -0.92 |
| shares outstanding | 551.3 | 534.9 | 514.3 | 277.5 | 239.3 |
| cash & investments | 880.3 | 823.8 | 803.0 | 921.2 | 399.9 |
| operating leases | 87.7 | 99.5 | 122.9 | 145.0 | 173.3 |
| total assets | 1,826.1 | 1,734.8 | 1,617.0 | 1,567.9 | 886.6 |

* 12 months ended August 3, 2024.

** Fiscal year ends January.

sources: company reports, the Bloomberg

yet to generate a GAAP profit. Nor is it expected to do so, at least through the fiscal year ending Jan. 31, 2028. Blame attaches, in part, to the high cost of hardware and, in part, to Samsara's own generous share-based compensation. Nevertheless, the aforementioned outsize sales growth has not gone for naught. Operating margins, adjusted for stock comp and one-time expenses, reached 6% in the second quarter after turning positive for the first time in last year's third quarter. And "adjusted" profitability is right around the corner, analysts expect, though even after adjustment there won't be much of that: The stock changes hands at 270 times the estimate for non-GAAP 2025 earnings per share.

The balance sheet dated Aug. 3 shows $880.3 million in cash and investments against operating lease liabilities of $87.7 million. In the second quarter, net interest income summed to positive $9.6 million compared to a $58.2 million operating loss.

Among the 15 analysts on the case, 9 say buy and none says sell. Bears, saying little, are registering their opinions through other means. Thus, short interest sums to 7.9% of the equity float, and insiders have unloaded 7.9 million shares for proceeds of $274.6 million since the start of the year.

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Perhaps the insiders and the short sellers have noticed that 23.3:1 price-to-sales valuation. Only a baker's dozen of U.S.-listed companies with a market capitalization higher than $10 billion (Samsara's weighs in at $26 billion) are so flatteringly priced. The list includes bitcoin-speculator MicroStrategy, Inc. (58.5 times), Palantir Technologies, Inc. (29.8) and Nvidia (26.9).

We wonder if Mr. Market has noticed that Samsara occupies a highly fragmented and competitive business niche. Headlines displayed on the review site Fleet Logging convey a sense of how crowded the market has become. For instance: "56 Best ELD Device Providers," "49 Best Telematics Companies & Fleet Solutions in 2024" and "36 Best GPS Asset Tracking Companies & Tracker Devices 2024."

While Samsara is frequently rated among the top vendors in product quality and customer service, it's not invariably No. 1. In late 2022, for example, the U.S. Postal Service put up its 230,000-vehicle fleet for a telematics bid. Samsara lost out to Geotab, Inc. and sued the post office to reconsider. After going over the bids a second time on Jan. 18, 2024, the USPS concluded that Geotab is a "better value" in both technology and price.

Samsara has indeed landed large customers, including DHL, XPO, Inc. and the city of Boston. However, Walmart, Inc. and Kroger Co. patronize competitor Lytx; Amazon.com, Inc. employs Netradyne; and Exxon Mobil Corp. and 7-Eleven, Inc. go with Motive. Given that all telematics providers use cellular signals to broadcast information, it's no surprise that Verizon Communications, Inc. (which purchased Fleetmatics Group plc in 2016) and AT&T, Inc. have also entered the competitive fray.

Knives have come out as competition has hotted up. In July 2023 Motive published a company-sponsored study conducted by the Virginia Tech Transportation Institute which found that Motive's AI Dashcam was better than its competitors'. It specifically asserted that the Motive technology picked up driver texting 71% of the time versus 30% for Samsara and 13% for Lytx.

Disputing those findings, Samsara filed suit in January 2024, alleging that, since 2018, Motive executives have created Samsara customer accounts under fake names for the purpose of pilfering Samsara's products and patents. In a Feb. 15 countersuit, Motive accused Samsara of creating false Motive customer accounts since at least 2016. Motive observes that Samsara got in the telematics business after it did and contends that many of Samsara's software interfaces bear an eerie resemblance to Motive's.

"We think Samsara was positioned as a best-in-class bundled solution a few years back when competing vendors tended to specialize in certain niches within fleet management," JPMorgan Chase & Co. analyst Alexei Gogolev, who is neutral on the stock, opined in June. "However, our analysis suggests Samsara faces incrementally more competition, which may reduce unit economics, especially for itself and other premium providers."

An analysis released last year by Spruce Point Capital Management, LLC, an activist short seller, highlighted the rising competition and commodification of telematic offerings and criticized Samsara's accounting. The company, as mentioned, gives away hardware in the service of locking customers into contracts of either three or five years' duration. For accounting purposes, Samsara chooses to amortize the hardware costs and sales commissions over five years.

However, Spruce Point charges that the "vast majority" of contracts span three years, not five. (Samsara reports no such information; Spruce Point says it arrived at its conclusions after a review of Samsara transactions with public sector customers.) Reducing the amortization periods for both equipment and commissions to three years would lower margins by more than 1,000 basis points, Spruce Point argues. To support this contention, it points out that Samsara often replaces customer equipment, i.e., cellular responders, more frequently than every five years. (How many of your cell phones have lasted for half a decade?)

Samsara, as mentioned, chooses not to disclose how much revenue each of its main products generates, nor the number of its paying customers, nor the rate at which those customers renew their contracts (or fail to).

True, Samsara did generate $18.2 million in trailing 12-month free cash flow, but $260.7 million of that sum derived from adding back share-based compensation, a non-cash expense. Samsara diluted shareholders by 4.4% in fiscal 2023, by 2.7% in fiscal 2024 and by 2% in the first two quarters of 2025.

At the investor-day festivities, management said it plans to reduce annual dilution over time to below 2% through a combination of paying higher cash compensation (which would reduce free cash flow), slowing headcount expansion (which may reduce growth) and initiating buybacks. On that last point, a company trading at 20 times revenue would need to spend 40% of sales on buybacks to offset a 2% annual dilution.

Sometimes a skyscraping valuation really is a problem.

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