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Cars.com, Inc. (CARS)

Q3 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the CARS Third Quarter 2022 Earnings Conference Call. This call is being recorded and a live webcast can be found at investor.cars.com. A replay of the webcast will be available until November 17. A copy of the accompanying slides can also be found on the company's Investor Relations website.

I'd now like to turn the call over to Robbin Moore-Randolph, Director of Investor Relations.

Robbin Moore-Randolph
Director-Investor Relations, Cars.com, Inc.

Good morning, everyone. And thank you for joining us. It's my pleasure to welcome you to the CARS third quarter 2022 conference call. With me this morning are Alex Vetter, CEO; Sonia Jain, CFO; Jandy Tomy, Executive Vice President of Finance and Treasurer.

Alex will start by discussing the business highlights from the third quarter, then Jandy will discuss our financial results in greater detail, and Sonia will provide an overview of our capital allocation priorities and our fourth quarter 2022 expectations. We'll finish the call with Q&A.

Before I turn the call over to Alex, I'd like to draw your attention to our forward-looking statements and the description and definition of non-GAAP financial measures, which can be found in our presentation. We will be discussing certain non-GAAP financial measures today, including adjusted EBITDA, adjusted EBITDA margin, adjusted operating expenses, and free cash flow.

Reconciliation of these non-GAAP measures to the most directly comparable GAAP measure can be found in the financial tables included with our earnings press release and in the appendix of our presentation. Any forward-looking statements are subject to risks and uncertainties. For more information, please refer to the risk factors included in our SEC filings, including those in our most recently filed 10-K, which is available on the IR section of our website. We assume no obligation to update any forward-looking statements.

Now, I'll turn the call over to Alex.

Alex Vetter

President, Chief Executive Officer & Director, Cars.com, Inc.

Thank you, Robbin. And welcome to our third quarter 2022 earnings call. I'm pleased to report that we delivered another quarter of solid results in line with our guidance. We are well-positioned to drive long-term sustainable growth, as we empower the auto industry to shift to end-market digital solutions to better compete for auto sales, increase transaction efficiency, and optimize for profitability.

Our third quarter revenue grew 5% year-over-year and our adjusted EBITDA margin was 30%. This momentum was driven by growth in traffic, dealer customers, and increased adoption of our Dealer Inspire and Accu-Trade solutions. These drivers, combined with our strong free cash flow conversion, demonstrate the strength of our integrated platform strategy.

We're particularly pleased with our steady and sustained performance in an operating environment that has been challenging for so many in our industry. Our dealer customer base remains healthy and our retention rates and value delivery remain strong. Inventory levels are starting to recover with daily average listings on our marketplace growing 11% year-over-year for new cars and 9% for used.

Despite increasing inventory, new car prices in our marketplace remain elevated at 14% higher than a year ago. Used car prices also remain high, but it declined 1% sequentially. With nearly 70 new car releases anticipated for 2023, we remain the optimal partner to support dealers and OEMs, as they will need to invest more in digital marketing to target in-market shoppers and sell more cars.

While inflationary pressures will continue to impact consumer spending, vehicle ownership is durable as car owners rely on their vehicles to transport their families, commute to work or for holiday travel. Whatever the reason, cars remain vital to the transportation needs of individuals as they go about their daily lives.

Even as the country experiences a recessionary environment, we know the auto industry to be resilient. Most recently in 2020, when the US economy came to a halt for several months, car sales in the US were still 52 million, against a 30-year average of 54 million a year. The Cars.com marketplace is essential for the buying and selling of cars. With over 27 million monthly unique visitors, we have an audience to match buyers and sellers at scale. We are pleased that this quarter we continue to expand our audience with 12% growth in unique visitors and 6% growth in total visits on a year-over-year basis. Dealers derive value not only from the strength of our traffic, but also from our portfolio of solutions. We grew our customer base to 19,585, an increase of 556 compared to last year and an increase of 68 from the second quarter, supported by strong retention.

Even in a challenging advertising environment, ARPD was strong at $2,334. We continue to expand our website business as nearly every OEM has selected us as a certified partner, which enables us to further add new dealers to our platform. As a result, our website customers grew to 5,900 at quarter end. We are also expanding our solutions strategy with additional end-to-end platform capabilities. With our acquisition of CreditIQ, we are expanding into the multi-billion dollar auto finance market, which enhances our platform as car shoppers can now better understand what they can afford and have the ability to complete more of the transaction online.

Our solution also provides dealers and lenders with a source of high quality financing leads while strengthening attribution to our marketplace. Our large in-market audience and low funnel shoppers are attracting leading financial institutions into our network. These additions, coupled with our increasing dealer adoption, are key to driving our flywheel and furthering our platform advantage.

One of the highlights of the quarter was the significant ramp up and roll out of Accu-Trade. This solution drives operational efficiency in the vehicle acquisition process for dealers, while also delivering a more transparent vehicle evaluation process for consumers. I'm pleased to report that at the end of the quarter we had over 400 dealers on our connected platform and we continue to sell and scale this offering.

There are approximately 25 million vehicle acquisition opportunities that we can help dealerships facilitate each year. Our Accu-Trade technology enables dealers to efficiently value and acquire inventory in both abundant or lean inventory environments. Trade-ins are a complicated yet critical process for dealers, as nearly half of all vehicle sales have a trade-in attached to the sale. However, the physical appraisal process is outdated and inconsistent, resulting in long wait times and highly subjective valuations.

Typically, the dealership has an individual who is in-charge with appraising all trade-ins, which on average can take up to an hour per vehicle, creating a bottleneck in the store and slowing the transaction process for both consumers and dealers. Accu-Trade's proprietary VIN-specific valuation and appraisal technology provides full transparency on vehicle valuation and delivers highly accurate appraisal reports, leveraging real-time market data in just minutes. Because Accu-Trade is so easy to use, it empowers more of the dealership staff to provide accurate appraisals, improving the overall dealership operation while creating a better and more efficient experience for the consumer.

This is the experience for Joel Bassam, President of Easterns Automotive Group, based in Washington, DC. He leverages our Accu-Trade trade appraisal technology and appreciates the efficiency it provides. Joel says, and I quote, "before using Accu-Trade, it would take up to an hour to appraise each vehicle, and now it takes as little as 15 minutes. With more than 1,800 vehicles appraised this quarter, this is a meaningful savings, cutting into our time spent by 75%. We recently adjusted our trade-in process onto Accu-Trade 100%, expanding the technology to all eight of our stores."

As evidenced by Joel, using our digital solutions is a game-changer. To strengthen our platform advantage, in August, we rolled out instant offer on Cars.com, which empowers private sellers to confidently receive a competitive cash offer based on real-time data in minutes. This gives the dealers additional access to buying opportunities from private sellers via Cars.com. They can also give consumers guaranteed offers from their own website, using Accu-Trade. We are just getting started on finding more ways to help dealers buy cars and are excited about the disruption we're driving as the auto industry shifts towards speed, accuracy and efficiency through tech.

In summary, our industry-leading brand, our high-value organic traffic, and our integrated platform of dealer-friendly solutions, coupled with the resilience of the auto industry, position us to drive growth and generate strong free cash flow.

Now, I'd like to officially welcome back Sonia, and thank Jandy for her leadership as Interim-CFO. I'm thrilled that both will continue to play integral roles in our organization. Jandy will first discuss our third quarter financial results in greater detail, and then Sonia will provide details on our capital allocation priorities and review our fourth quarter expectations.

Jandy?

Jandy Tomy

Executive Vice President-Finance & Treasurer, Cars.com, Inc.

Thank you, Alex. Like Alex, I'm pleased with our steady and sustained performance. For the quarter, we delivered strong revenue, adjusted EBITDA and operating cash flow. We continue to drive profitable growth even amidst challenging economic headwinds, a testament to the benefits of our diversified set of solutions.

Revenue for the quarter totaled $165 million, a 5% increase compared to the prior year. Our performance was driven by continued growth in dealer revenue, which grew 4% year-over-year to $145 million. Although our new car inventory and production remain low, our OEM and National revenue was only 2% lower compared to a year ago and up 5% sequentially.

Turning to expenses. For the quarter, adjusted operating expenses, excluding depreciation and amortization, were $113 million, $2 million higher than a year ago as a result of the addition of the CreditIQ and Accu-Trade acquisitions and other investments to drive growth. Compared to the second quarter, our adjusted operating expenses were $3 million lower, driven by lower marketing spend as a result of our strong growth in traffic and unique visitors, which enabled us to pull back on marketing investments during the third quarter.

Due to revised performance expectations associated with our recent acquisitions, the fair value of the earn-outs increased by $13 million, which drove a net loss of $2.9 million or $0.04 per diluted share compared to net income of $2.4 million a year ago. This increase in our earn-out estimates is indicative of the progress we've made in integrating our recent acquisitions. We delivered adjusted EBITDA of $50 million or 30% of revenue at the midpoint of our guidance. Sequentially, margin expanded 250 basis points.

Now turning to our key metrics, which underlie these solid quarterly results. Driven by sustained strong retention rates and new sales, we grew customers by 556 dealers or 3% year-over-year, putting us at 19,585 at quarter end. Sequentially, customers increased by 68. Monthly ARPD increased by $2 year-over-year to $2,334 for the quarter and by $8 compared to the second quarter. Our performance resulted from growth in our digital solutions, largely offset by softness in fuel sales and marketplace inventory downgrades due to lean inventory levels. Website customers continued to grow reaching 5,900 at the end of the quarter, up 700 from a year ago and 250 sequentially. Dealer Inspire revenue in total grew 16% compared to the prior year.

Car shoppers continue to rely on our marketplace to help them find the right vehicle. We consistently generate high-quality traffic and an engaged audience at scale, which our dealer and OEM customers value. For the quarter, traffic increased 6% to 150 million visits, and monthly unique visitors, which best represent in-market car shoppers, increased 12% to 27 million.

And now, I'll turn the call over to Sonia, who will discuss our capital allocation priorities and provide our fourth quarter outlook. Sonia?

Sonia Jain

Chief Financial Officer, Cars.com, Inc.

Thank you, Jandy. Cash provided by operating activities for the nine-month period ending September 30, 2022, was $91 million and free cash flow was $77 million. Cash flow in the current year period was down year-over-year for two primary reasons. First, last year we had a $9 million income tax refund associated with the CARES Act. And second, the unfavorable impact from changes in working capital.

As Jandy mentioned, given the revised performance expectation for our recent acquisitions, we recorded a net $13.4 million increase in the fair value of the earn-outs. This reflects our momentum in driving market acceptance and our integration efforts. With this adoption, we expect to pay $10 million related to these earn-outs over the next 12 months. Overall, we believe the earn-out structures associated with these acquisitions are an attractive way to align incentives and provide us upside as we continue to integrate scale and sell these solutions.

Net leverage at quarter-end was 2.6 times, down compared to 2.8 times last quarter and approaching our target range of 2 times to 2.5 times. Recall that we are temporarily above our target range due to incremental borrowings in the first quarter from the Accu-Trade acquisition. Given our strong, consistent cash generation, we are comfortable at this level and anticipate getting back into our target range in the coming quarters. I'd also like to remind you that our floating rate debt is only 21% of our total outstanding, limiting our exposure to rising interest rates.

We continue to maintain ample liquidity with $195 million of cash available on our revolver to supplement our $32 million of cash on hand. Our strong balance sheet provides us with the financial flexibility to return capital to shareholders. During the quarter, we repurchased 1.4 million shares for $17 million, bringing our total shares repurchased this year to 3.5 million, representing 5% of our shares outstanding. Overall, our performance and strong execution enables us to deliver a balanced capital allocation strategy that is focused on creating shareholder value by investing in the business for growth and delevering our balance sheet and buying back shares.

Now turning to our guidance. For the fourth quarter of 2022, we expect to deliver revenue of approximately $165 million to $167 million, representing both sequential and year-over-year growth, in what remains a challenging macro environment. Our outlook is balanced with continued growth in our digital solutions and recent acquisitions. And while we are seeing signs of improvement when it comes to inventory, our views are tempered by the current economic environment, inflation and rising interest rates.

Turning to the fourth quarter adjusted EBITDA margin, we expect to be between 28.5% and 30%. This outlook reflects our anticipated revenue mix and modest increases in marketing and sales, and product and technology investments to drive growth. We have a demonstrated ability to generate attractive margin and deliver solid cash flow, even as we invest in the business. And in this challenging economic environment, our diversified set of solutions positions us well to continue delivering profitable growth.

With that, I'd like to turn the call back over to Alex.

Alex Vetter

President, Chief Executive Officer & Director, Cars.com, Inc.

Thank you, Sonia. Our asset-light business model has proven both resilient and sustainable in many market conditions. Revenue is growing and diversifying across multiple solutions, while margins remain strong. We're confident in our ability to continue to grow revenue, as we execute our differentiated platform strategy.

Operator, we're ready to begin Q&A.

QUESTION AND ANSWER SECTION

Operator: Absolutely. [Operator Instructions] Our first question comes from the line of Tom White with D.A. Davidson. Tom, your line is now open.

Tom White
Analyst, D.A. Davidson & Co.

Q

Great. Good morning. Thanks for taking my questions. And welcome back, Sonia. First on the guidance, I think last quarter the guide was for 6% to 8% year-over-year growth for the second half. The 4Q range that you gave today implies the second half growth will be I think closer to 5%. Can you maybe just peel back a bit on maybe what parts of the business you're either seeing a little bit of softening or you're maybe feeling a little bit more conservative about? And then I've got a follow-up.

Alex Vetter
President, Chief Executive Officer & Director, Cars.com, Inc.

A

Sure, Tom. Good to hear you. Well, listen, I think we're on one hand, we're pleased with the midpoint of the range, but internally we would have aspired to deliver on the high-end of the range. And on a subscription business, that midpoint obviously impacts the full year, albeit only for the three months remaining. And so, I think that's number one.

I think, number two; we pulled back in our marketing in Q3 a bit. We're seeing strength in traffic, both organic and value delivery, but really what the key difference is that we're seeing strength in our solution sales, which takes a little bit longer to enable dealerships, set them up and make them billable, and at the same time some softness in advertising as we finish out the year. So those are the factors.

I don't know Sonia, what else you'd add to that?

Sonia Jain
Chief Financial Officer, Cars.com, Inc.

A

No, I think just maybe a little bit more color at least on the on the revenue range. So Alex spoke a little bit about the Q3 numbers. But we're feeling confident about the strength of the diversified platform. As Alex mentioned, a lot of strength in the solution side of our business, which is offsetting a little bit of the softness that we saw also in Q3 on components of the advertising business like fuel. And one other really strong bright spot has been the improvement we've seen in dealer customers in Q3, a lot of that momentum we're seeing continue into October and we're pleased with the ability to add dealers and grow ARPD even if modestly.

Tom White
Analyst, D.A. Davidson & Co.

Q

Okay. That's helpful. Thanks. Maybe just to follow up on the National ad revenue line. Alex, I think I heard you mention that I think it was 11% growth in new vehicle listings on the platform. It sounds like that kind of rising inventory maybe bodes well for eventually OEMs, starting to spend a bit more to support their local dealers. Just curious like have you had any discussions with OEMs? Do you have any general visibility on when that line might perk up or if you haven't had discussions, maybe what your best kind of crystal ball-type guess is about how that line might evolve in 2023?

Alex Vetter
President, Chief Executive Officer & Director, Cars.com, Inc.

A

Sure, Tom. Well, look, I think first and foremost, we're maintaining a really what I consider a conservative outlook on OEM and National just because of the current environment and climate. And while inventory levels are improving, they really vary across OEMs. And so there are many OEMs that are still having material production challenges. I think when I look ahead to 2023, what I'm excited about is the volume of new product launches coming into the market. And OEMs typically need to invest, promote those new model launches with events and incentives, which have been greatly reduced over the past, call it, two years.

And so fourth quarter, not really expecting to see a lift in that and we'll be back to you more with the 2023 outlook. But the conversations we're having are productive, very positive. I think OEMs like dealers recognize they have to shift towards more digital solutions. We know a lot of their investments over the last few years have gone to these social media platforms that I think haven't really done much to convert to vehicle sales. And that's our bread and butter. We're a retail media network and if OEMs want to move units at the retail level, we can aid them in that effort.

Sonia Jain
Chief Financial Officer, Cars.com, Inc.

A

And maybe just one additional point to add. We are really pleased to see kind of the listings uptick, and it is a really promising green shoot, especially coupled with the model launches that are expected for next year. That being said, inventory came down pretty dramatically, especially on the new car side. So we are growing off of a lower base and this is the beginning I think of that ramp up that we will see evolve over a number of quarters.

Alex Vetter
President, Chief Executive Officer & Director, Cars.com, Inc.

A

That's right.

Tom White
Analyst, D.A. Davidson & Co.

Q

Got it. Makes sense. Thanks, guys. I'll get back in the queue.

Alex Vetter
President, Chief Executive Officer & Director, Cars.com, Inc.

A

Thanks, Tom.

Operator: Thank you for your question. Our next question comes from the line of Naved Khan with Truist Securities. Naved, your line is now open.

Naved Khan
Analyst, Truist Securities, Inc.

Q

Thanks. Thanks a lot. I just want to maybe peel back the dealer retention metric. So the dealer count increases, but maybe give us some more color on the listing side, how is that working? And did you see – did you lose customers there or what are the trends that you're seeing into October? Also on the Dealer Inspire side, is Subaru starting to contribute there or do they still have to be – is there a waiting period there before they start onboarding the dealerships over there?

Sonia Jain
Chief Financial Officer, Cars.com, Inc.

A

Yeah. So related to your dealer customer question, the increase that we saw in Q3 was really driven by our solutions additions. And one of the things we're transparently super-focused on just the ability to continue to cross-sell our solutions products into our marketplace customers. For the October, where we have seen a continuation of that dealer customer growth, we're seeing both additions in marketplace as well as well as the solution side of the business and retention rates, we have visibility looking forward and retention rates look strong.

Alex Vetter
President, Chief Executive Officer & Director, Cars.com, Inc.

A

Yeah. I think also on the – I think that can be buoyed also going into next year with the addition of CreditIQ. We're seeing really strong excitement by progressive dealers to do online financing, which will help on retention for next year. But on your question on Subaru, yes, those launches have begun and we see good optimism there in terms of our ability to continue to grow that dealer base.

Operator: Thank you for your question. Our next question comes from the line of Marvin Fong with BTIG. Marvin, your line is now open.

Marvin Fong
Analyst, BTIG LLC

Q

Good morning. Thanks for taking my questions, and welcome back, Sonia. My first question is just on Accu-Trade, sequentially very, very impressive growth. Obviously small compared to the total number of dealers you have. Just wondering, how did that perform against your internal expectations? And could you just provide us some guideposts on how we should evaluate your progress there maybe a year from now or two or three, like where do you think or how should investors think about your path of growth there? And then I have a follow up.

Alex Vetter
President, Chief Executive Officer & Director, Cars.com, Inc.

A

Well, look, I think we've been very pleased with the initial reception and market reaction to Accu-Trade. I think dealers overwhelmingly are looking to source sales directly from the public as a more cost-effective way to not only acquire inventory but also new customers. And so response has been extremely positive there as well as on our appraisal technology. I think we sit here today what I think is in the very early innings of a doubleheader game. We are working feverishly on dealer enrollments, right, training dealerships.

Unlike marketplace [indiscernible] (00:26:18) which we can turn on in 48 hours, Accu-Trade has a longer onboarding cycle. And so, we are investing there to help improve the dealer onboarding experience, to train the staff and get them up and running and using the technology. I think the progress we've made this year is like every product we've ever introduced, which has an initial wave of dealers working through the enrollment issues and then we move towards scale.

And so, this time next year I think we'd like to see not only our subscription numbers more than double, but I think the early progress around dealer-to-dealer trading, we'd like to get that launched sometime next year where dealers can now start to trade inventory using Cars.com retail demand data to help inform time to sale and informing them when they should get rid of a car and perhaps sell it to a dealer in another region. So we'll give you more guidepost as we get further along this initial enrollment period. But needless to say that the industry interest here is widespread.

Marvin Fong
Analyst, BTIG LLC

Q

Thanks so much for that color. And my follow-up just on fuel, I think you've mentioned a little bit incremental softness there. Could you just help decompose that? I mean I think inventories have improved a little bit, but would you say that's still mostly because dealers are inventory constrained or is it the macro environment that's kind of creeping into some of the headwinds there?

Alex Vetter
President, Chief Executive Officer & Director, Cars.com, Inc.

A

Yeah. Most of our softness in fuel in Q3 was the former, right, which is dealers said to us, I don't have enough inventory, I've got multiple buyers on every piece of inventory, I don't need to spend more promotional dollars to exhaust what is already a healthy turn rate for my inventory. What I see now happening though, is new car inventory levels are starting to rise, again to Sonia's point, it's early. But as dealers take on more new car inventory, in addition to having more used cars in the ground, they will need to return to in-market spending to help exhaust that inventory and move that volume. And so I think the slowdown on fuel is more inventory related in the most recent period. And I see a bigger opportunity brewing there for 2023 for sure.

Sonia Jain
Chief Financial Officer, Cars.com, Inc.

A

Yeah, no. I would just echo everything Alex said. We're still currently sitting, I think somewhere around 600,000 on the new vehicle side relative to highs of over 2 million. So we are getting back. We're sort of climbing up this hill from an inventory perspective and I think positive signs, but not quite there yet. And I'll also just add, fuel, not only does it give dealers access to an end market audience, but it also does so far more efficiently than any other product that's out there. So as they're thinking about their portfolio in their marketing mix, we provide benefits in the targeting side, but also just from a pure cost effectiveness.

Marvin Fong
Analyst, BTIG LLC

Q

Thanks. That's great. Thanks, Alex, and Sonia.

Operator: Thank you for your question. [Operator Instructions] Our next question comes from the line of Doug Arthur with Huber Research. Doug, your line is now open.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Yeah, thanks. And Sonia, welcome back. Alex, just sort of big picture. Obviously, the pricing in used cars has broken somewhat. I mean I wouldn't say it's plunging, but it's rolling over sort of. And I missed the first couple of minutes of your presentation. Just sort of broadly, how is that impacting dealer and customer behavior as prices start to come down? I mean, is there hesitancy in the market to transact because people want to see where prices land or is it not having much of an impact?

Alex Vetter
President, Chief Executive Officer & Director, Cars.com, Inc.

A

Yeah. Doug, I think, as you know, I've seen other marketplaces or other players report that used car values are falling at a greater level. As you know, Cars.com and our entire business model tends to skew up markets with the larger franchised dealers. And there's been a slight softening in used car pricing, but it's largely driven by the increase in new car inventory supply. I believe, as opposed to a macro consumer issue, the luxury market remains healthy in all economic cycles and we're not as impacted by the long tail or the sub $10,000 vehicle market. We tend to skew more to the higher end of the market there.

I think, as you know, the new and used car markets ultimately battle for share. And so, OEMs I think are going to be coming back hard in 2023, trying to move new product. There's a record number of launches scheduled for next year, which is exciting because users are flocking to Cars.com to learn about EVs and we're well-positioned in that market. But the used car softness in the market, I think is a little premature because consumer demand is persisting. If you look at our traffic levels, relatively strong in Q3, and we see that same consumer demand persist into Q4.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. Great. Thank you.

Operator: Thank you for your question. There are no more questions waiting at this time. So I will pass the call back to Alex Vetter for closing remarks. Thank you.

Alex Vetter
President, Chief Executive Officer & Director, Cars.com, Inc.

Thank you for your interest in CARS, and joining us today. And that concludes our call.

Operator: This concludes today's conference call. Thank you for your participation. You may now disconnect your line.