30-Jul-2020

Cars.com, Inc. (CARS)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Cars.com Second Quarter 2020 Earnings Conference Call. Hosting the call this morning is Alex Vetter, Chief Executive Officer; and Sonia Jain, CARS' newly appointed Chief Financial Officer. Also joining us on today's call is Jandy Tomy, who served as Chief Financial Officer during the second quarter. 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 August 13. A copy of the accompanying slides can also be found on the company's investor site. Following today's presentation, there will be a question-and-answer session with Alex, Sonia and Jandy.

I'd now like to turn the call over to Kamal Hamid, Director of Investor Relations.

Kamal Hamid

Director-Investor Relations, Cars.com, Inc.

Good morning, everyone, and welcome to our second quarter 2020 conference call. 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 our 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 net income and free cash flow.

Reconciliations 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 the presentation. For more information, please refer to the risk factors included in our SEC filings including those in our annual, quarterly and current reports. We assume no obligation to update any forward-looking statements or information as of their respective dates.

At this time, I would like to turn the call over to Alex.

T. Alex Vetter

Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

Thank you, Kamal. Good morning, everyone, and welcome to our conference call for the second quarter of 2020.

Before I begin to discuss the quarter, I want to take a moment to introduce Sonia Jain, our new Chief Financial Officer who joined CARS on July 6. She hit the ground running, moved to Chicago and worked with both financial and operating team members to quickly learn our business. Sonia's deep multi-channel media distribution expertise and technology prowess have enabled her to have an abbreviated learning curve and she's poised to make an immediate impact as an important business partner to me and a major contributor to our strategic goals.

Sonia Jain

Chief Financial Officer, Cars.com, Inc.

Thank you, Alex. I am very happy to join my first CARS earnings call. In the short time since I joined CARS, I've seen firsthand the team's alignment and focus on leveraging our portfolio of first party data and solutions to further our inherent strength in the marketplace. I thank Jandy and the team for their efforts, particularly in light of the obstacles the COVID-19 pandemic placed in their path. And I look forward to working closely with the analysts and portfolio managers on today's call and meeting you soon at least virtually.

T. Alex Vetter

Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

Thank you, Sonia. Now let's discuss the quarter. As we signaled last quarter, the pandemic impacted our customers, and therefore, our business as well. Our decision to provide a three-month financial stimulus to dealers in the form of 50% off in April and 30% off in May and June obviously led to substantially reduced second quarter revenue and adjusted EBITDA. But our form of stimulus also reinforced our commitment to dealer advocacy. When combined with all of our other proactive product and customer support, we believe dealers will long remember that we stepped up in a challenging time for their business.

Our position as a leading marketplace was apparent with strong organic traffic and even stronger lead conversion in the quarter. Dealer retention rates improved as the quarter progressed and it further strengthened in July and we continue to drive new revenues with the release of new DI websites and additional Q2 fuel launches, both of which demonstrate strategic and economic value of our diversified revenue platform.

From a more strategic perspective, we believe dealers now have an even greater appreciation of our brand and SEO strength than ever before. We reliably delivered traffic and exceptional lead growth in the quarter despite our reduced marketing spend. Our organic traffic continues to be an important distinction between Cars.com and competitors, and our diversified range of digital solutions even further differentiates us from others.

While overall national car sales suffered in March and April, recent trends in car sales have been encouraging. Nevertheless, it is not yet prudent to make definitive predictions about how the pandemic will affect demand across the nation for cars in our business. But we are very pleased with how well our business model performed under the circumstances and how our unique strategy and core strengths position us to manage through a volatile auto environment and emerge poised to become the market leader.

To put the quarter in perspective, I should first highlight our industry volatility from April to today. New car sales started the year with a projected SAAR of 16.9 million units. This fell to 11.4 million in March and 8.7 million in April, an extraordinary 48% drop from the beginning of the year. New car sales have since rebounded at a pace exceeding most expectations. SAAR in June increased to 13 million, up 49% from the April bottom. Bear in mind that June's level is well below beginning of the year expectations. Industry revenues also reflect a combination of new car demand, supply considerations and low dealer inventories, which have led to a 3.1% year-over-year increase in new vehicle average transaction prices.

Used car sales have seen a similar rebound in volume and all-time highs in auction prices. Used car sales averaged 3.3 million units per month in January and February, up 2% year-over-year before dropping by 49% in March to 1.7 million units. By June, used vehicle sales had rebounded by a 102% to 3.4 million units. At the same time, tight supply and high demand led to an 11% year-over-year increase in used car values.

Our entrepreneurial dealers have pivoted quickly in this uncertain, and thus far, lower volume environment. Many have partially or fully mitigated negative bottom line impact with the combination of reduced but recovering new and used car sales volumes, rising sales prices and reliance on more efficient digital sales. Dealers have increased the ROI of their marketing spend by relying less on search engine marketing, while at the same time keeping reduced staffing levels and further driving profits from service operations. Overall, the industry response has been both impressive and resilient.

In Q2, our audience metrics increased by double-digits year-over-year reaching 144 million visits or up 10% during this period. Unique visitors grew 6% year-over-year. Keep in mind, the quarter started out very soft with steep traffic declines in April, followed by double-digit growth in traffic in unique visitors in May and June year-over-year. We also achieved strong SEO traffic and SEO lead generation with June marking our second consecutive month for record-breaking SEO traffic, with 31% growth compared to June of 2019. Second quarter 2020 SEO entries set a new quarterly record with 37.5 million entries into our website by clicking on search engine results.

Mobile traffic grew 75% of our total traffic, up from 71% one year ago and notably, we performed well on quality measures as well as traffic to lead conversion increased 12% compared to the second quarter of 2019. We delivered this performance despite reduced marketing spending, which speaks to the strength and resilience of our consumer brand, the core of our strong organic traffic momentum. Unlike many of our competitors, we aren't solely dependent on paid marketing to build traffic. Instead, our leading brand position and unmatched editorial content have shown to be powerful tools to attract a large car buying audience in all market conditions.

Our dealer count declined in the quarter weighted down by early lockdown months. Cancel requests had begun in mid-March and peaked in May. We took quick action to offset cancellations. Temporary dealer pricing relief and a growing awareness about the value of digital solutions for selling cars in a virtual environment made a big difference in retaining many dealers that were experiencing pain and facing early uncertainty. Cancellation rates normalized in June and July. In fact, July showed the highest retention rate of the prior four months and a higher rate than one year ago.

While new marketplace sales were slower than the first quarter, this was partially offset by growth in solutions-only customers resulting in a 5% decrease in dealer customers compared to the previous quarter. Overall dealers increased the adoption of our digital selling tools after seeing how effective they were in meeting the needs of consumers, particularly those purchasing without visiting a showroom. In fact, our internal research shows approximately 70% of shoppers want to execute at least some parts of the auto purchase online and dealers are rapidly advancing to support home delivery.

We also helped our dealers to remain safely open for business during the pandemic period by advocating to have them classified as an essential service, which had a critical impact on their business and further solidified CARS as a true dealer advocate. The three-month financial stimulus we provided for dealers to help them sustain their business was communicated swiftly in March but only after consultation with our dealer network to ensure our support, cover the quantum and period necessary under the circumstances.

Our financial backing was imperative to support and stabilize our dealers and demonstrate our long-term commitment to the industry. Standard subscription pricing resumed as of July 1, and thus far, in July, retention is at or above the rates experienced in the second half of 2019 and in 2020 prior to the pandemic.

With rising traffic, limited vehicle sales and an increased reliance on virtual selling, dealers are beginning to inquire about additional solutions and programs that can help them succeed digitally. Our strategy to unite media, digital solutions and data to drive efficiencies and profitability in the industry is becoming even more essential in a COVID world and beyond. This is true competitive differentiation. The seamless integration of our portfolio of products and solutions support dealers seeking to adopt a manageable digital strategy and consumers as they research their best vehicle match, and the breadth of our portfolio provides solutions for and loyalty from our customers.

We saw this firsthand as dealer websites were essential during COVID and we experienced few cancellations and saw an increase in solution utilization. At a time when dealers were slashing costs, they continue to leverage the CARS product portfolio to operate digitally. The most vivid example of this integrated strategy and action is our new offering FUEL. FUEL leverages Cars.com's first-party data, Dealer Inspire's delivery technology and our media production capabilities to power targeted videos in geographic zones.

This rapidly growing ARPD accreted solution targets our audience reach with in-market car shoppers, while they engage with online content and streaming platforms. Last quarter, we featured Brian Benstock of Paragon Honda and Acura. These dealerships use only CARS solutions and he adopted FUEL when Manhattan and the Bronx were under lockdown, but they were allowed to deliver cars to people's homes. Per Brian, Paragon Honda and Acura achieved number one status in sales nationally for both new cars and certified pre-owned sales during the month of June. We believe this is a powerful demonstration of our digital solutions effectiveness, as Paragon is leveraging FUEL to grow share in a city that was once deemed the epicenter of COVID in the United States.

As Brian told us last quarter, Paragon is solid proof point that dealers gain market share by using the CARS platform exclusively. Brian told The Wall Street Journal "business plummeted at the end of March. In April, the dealership sold 342 cars, all online, while in June, it sold 1,130 cars, both online and through virtual dealer appointments." We are seeing similar results at other dealers throughout the nation, including a recent testimonial from Toyota of Cedar Park, a dealership in the Austin market. They reported incredibly strong click through rates during the pandemic, with a more than 200% increase in direct traffic to their dealer website in the second quarter compared to the prior year period and a threefold increase in appointments at their dealership during the height of the pandemic, in part driven by the use of the FUEL platform.

Going forward, we continue to expect FUEL to positively contribute to revenue and profitability with ARPD rates that are multiples higher than the CARS' overall average revenue per dealer. Another success of our solution strategy is the traction we saw with high conversion rates for Online Shopper, our digital retail solution and

Conversations, our online chat tool from Free 60-day promotions converting to paid usage. By the end of the quarter, more than half of free users of Online Shopper had converted to paid and Conversations converted more than one-third of free users.

As we discussed last quarter, our online digital retail solutions Home Delivery and Virtual Appointment badging continued to be in high demand from our dealers. By the end of June, thousands of dealers were offering home delivery and more than 2 million vehicles have been badged by some 8,000 dealers nationwide. Dealer Inspire continues to deliver solid results with revenue flat year-over-year, an impressive accomplishment in an uncertain environment. This demonstrates the persistent demand for best in market technology, the stickiness of our solutions offerings and the benefits of diversity in our portfolio of dealer revenue streams.

Along with the innovative solutions we talked about earlier, DI's website solutions continue to be essential for OEM customers. This quarter, we became the preferred provider to Nissan and others, bringing our total number of endorsements to 37 OEM brands representing about 90% of the OEM brand selling cars in the United States. We continue to take market share from incumbents selling legacy technology. Semi-exclusive GM partnership we previously announced continues to reflect our product superiority. So far, we've launched over 60 of the more than 800 contracted GM websites and expect to launch the majority of these contracted GM websites by the end of the year. As websites continue to launch, the related subscription revenue for this program will build throughout the second half of 2020 and establish a strong starting point for 2021.

Turning to our national advertising business, it was down 17% year- over-year as OEMs pulled back spending during COVID. However, demand has been building in recent weeks as OEMs are rethinking social platforms and seeking trusted brand safe environments to efficiently sell cars. They become wary of their ads being displayed alongside negative content and misinformation. We're leveraging our inherent reputation in high-quality and market shopping audience to redirect industry ad dollars to spending with cars.

This opportunity combined with the strong leadership team and our strong organic traffic and improved product performance positions us well for future growth. This past March we took swift actions to address and offset the revenue and cash flow impact of our significant dealer stimulus. In total, we've reduced operating costs by $28 million compared to the prior year period, the majority of which were short-term reductions in reaction to lower revenue in the second quarter. Sonia will provide more color in a few minutes.

We also secured substantial liquidity and balance sheet flexibility through an amendment to our credit facility, waiving our net leverage and interest coverage covenants for the remainder of 2020. This combined with our positive cash flow gives us an ample cushion through the credit facilities expiration in 2022. Our organization has been productive and agile operating in a leaner virtual environment. Although it was a difficult decision, we furloughed approximately 250 people and ultimately exited approximately 170 of the furlough group. I thank them for their contributions to CARS.

We have since brought back about 50 furloughed employees and we expect to begin hiring in targeted areas of the business in the second half of the year to accelerate our path to market leadership, while being mindful of evolving market conditions when considering those decisions. As the market conditions begin to steadily show signs of improvement, we will resume spending in key areas and see increased investment into our growth agenda.

Now, I would like to address CARS' continuing proactive approach to diversity and inclusion. In recent months, our country has again faced many conspicuous examples of inequality and social and racial injustice. Diversity, inclusion and belonging have long been part of the CARS' mission and strategy. In this quarter, we have taken even further sustainable actions in our company, our industry and in our local communities. Our program prioritizes, institutionalizes and measures the creation of a diverse pipeline of talent and equitable practices for hiring, promotion and salary structure at every level. We have gone further by expanding our industry focus.

In the automotive industry, only 1,243 dealers are minority-owned, and of that just 265 are black-owned. Therefore, we have partnered with the National Association of Minority Automobile Dealers to advance this mission to help black-owned dealerships thrive through technology and retail solutions with the program of CARS sponsor education and training sessions. And we are leveraging our preferred relationships with social media partners to seek and secure co-op funds to black-owned dealerships.

And for our communities, we have launched CARS Action which provides volunteer resources and connections for our employees to help rebuild and revitalize under-resourced communities. We are committed to driving sustainable and meaningful change in our company, our industry and our communities for the long-term.

At this time, I'd like to turn the call over to Sonia to discuss our financial results for the quarter. Sonia?

Sonia Jain

Chief Financial Officer, Cars.com, Inc.

Thank you, Alex. Revenue for the second quarter of 2020 was $102 million compared to $148.2 million in the prior year period. The decrease was primarily due to the invoice credit of 50% in April and 30% in May and June of 2020 that we provided to our marketplace customers. Year-over-year, DI revenue was flat, while national advertising revenue declined 17%.

Now, let me move into a discussion of our operating expenses in the quarter. Total operating expenses for the second quarter of 2020 were $119.2 million compared to $147.2 million for the prior year period. Our action to manage cost in an uncertain COVID environment drove the vast majority of our year-over-year savings. The decrease was primarily due to lower marketing spend and reduced head count expense, the majority of which was not intended to be a permanent reduction. Marketing spend reductions were offset by increased efficiencies and a more favorable SEM pricing environment due to the market wide pullback. As a result, despite our reduced spend, we continue to deliver strong traffic and high-quality leads to our customers.

GAAP net loss for the second quarter of 2020 was $24.6 million, or $0.37 per diluted share, compared to a GAAP net loss of $6 million, or $0.09 per diluted share, in the second quarter of 2019. Adjusted net income for the second quarter of 2020 was $8 million, or $0.12 per diluted share, compared to $20 million, or $0.30 per diluted share, in the second quarter of 2019. Adjusted EBITDA for the second quarter of 2020 was $23.2 million, or 23% of revenue, compared to $43.5 million, or 29% of revenue, for the prior year period.

For the second quarter, average monthly unique visitors grew 6% year-over-year and total traffic grew 10% year-over-year. We grew traffic across all our channels despite reduced marketing spend. The gains were driven by continued efficiency in SEO and performance marketing, consumer demand for vehicles and increased adoption of online car shopping. Mobile traffic grew 16% year-over-year and accounted for 75% of total traffic compared to 71% in the prior year.

We had 18,033 dealer customers as of June 30, 2020, a decrease of 5% compared to the 18,938 dealer customers as of March 31, 2020. This is primarily due to higher cancellations and reduced sales in marketplace dealer customers who are reacting to mandated closure of their dealership and concerns around market softness. However, at the same time, our website customers grew to 3,800 in the quarter.

ARPD was $1,442 in the second quarter of 2020, down 33% year-over-year, primarily due to invoice credits we provided to our marketplace customers of 50% in April and 30% in May and June. Adjusted for the second quarter discounts, ARPD was approximately $2,098, down 3% compared to the prior year and up slightly compared to the first quarter.

Net cash provided by operating activities for the six-month period ending June 30, 2020, was $57.6 million compared to the $50.8 million in the prior year period. Free cash flow for the six-month period ending June 30, 2020, was $48.9 million compared with the $41.4 million in the prior year period. Cash flow during the quarter benefited from positive changes in working capital, which is expected to be partially offset in the third quarter.

Including availability under our revolving credit facility, total liquidity stood at $232.2 million as of June 30, and has since grown to approximately $240 million. As you recall, given the uncertainty around the impact of COVID-19 to our business, we took the prudent action to amend our credit facility and under the terms of our amended credit agreement, our net leverage and interest coverage ratios are waived for the balance of 2020. That said, we ended the quarter with net leverage of 4.1 times.

Our business has a strong cash flow profile which we believe is the highest in our competitive set. Our business is asset-light, requires minimal capital expenditures and working capital needs are relatively neutral. This results in a consistently high conversion of adjusted EBITDA into free cash flow.

As discussed in the face of the pandemic we took prompt actions to support our dealer customers while reducing our expenses. Our goal was to offset at least 50% of the anticipated revenue reductions resulting from our dealer credit and other COVID-related revenue decreases. We were successful in our efforts and offset approximately 70% of our temporary revenue reductions through cost reductions, some of which were permanent, but the majority of which were intentionally temporary.

Looking forward, we expect to reinvest in areas of the business that supports growth. Marketing spend is expected to increase as the SEM environment becomes more competitive, a trend we have already noticed in the third quarter of 2020. In addition, we expect to begin hiring in targeted areas of the business to drive growth in product launch and website deployment.

Effective July 1, we reversed the 10% across the board pay reductions we had implemented on April 1. This is important to remain competitive for talent and to ensure we are investing in our most critical asset, our people. We have a demonstrated commitment through identifying cost efficiencies and remain focused on maximizing free cash flow. While spend may increase in a measured way as we return to a more typical operating environment, we are ever mindful of being thoughtful stewards of capital.

Turning to our outlook, as you are aware we suspended our guidance on March 23, 2020, given the uncertainty generated by COVID. The effects of the COVID-19 pandemic and resulting lower number of dealer customers will naturally impact subscription revenues, results of operations and cash flow. However, the extent of the impact will vary depending on the duration in the course of the pandemic, related restrictions, and the resulting impact on the macroeconomic environment. Our strong brand and high concentration of organic value generates a strong cash flow profile and strong liquidity that position us well to weather this storm. Our differentiated and diversified solution equally enable us as we resume our path to market leadership.

And now with that, let me turn the call back to Alex.

T. Alex Vetter

Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

Thank you, Sonia. As Sonia mentioned, in the current volatile business, the auto sector and health environment, it's premature to predict and quantify actions and impact of the ongoing COVID-19 pandemic for the remainder of the year. The data shows that car buyers increasingly came back to the market starting in May and continuing through July. Data further shows that higher and growing proportion of car buyers are completing transactions online and having the cars delivered directly to their homes, a far more efficient process for both the dealer and the consumer.

We expect to judiciously increase our marketing spend, while maintaining our high level of value delivery our dealer customers expect from CARS, and at the same time, focus on the efficiency of our traffic and lead generation where we enjoy competitive advantages. We continue to focus on the things we can control, namely our strong customer service and solutions offerings to dealers, our highly disciplined expense controls and our continued focus on free cash flow and balance sheet flexibility, and we believe we have the industry's most powerful platform, one that was really built for the disruptive car buying market that we're in today.

We hear this feedback from dealers and we see it in our year-to-date traffic numbers. We continue to feel confident this difficult time provides CARS a great opportunity to emerge from this period even stronger with category leadership.

Now, before we go to the Q&A session, I want to extend my thanks to Jandy for her dedication to CARS as interim CFO during the last six months. She's been a disciplined leader during these extraordinary times and should be recognized for her efforts to modify our credit agreements and for guiding our finance team during this challenging period. Jandy is an exemplary leader. Fortunately, for us, Jandy will continue to contribute to CARS as Treasurer and support Sonia's rapid assimilation as CARS' CFO. Thank you, Jandy.

With that, I'll open up the call for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Lee Krowl with B. Riley FBR. Your line is now open.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Great. Thanks for taking my question and nice job on a fairly solid quarter, all things considered. Wanted to just really focus on the digital retailing aspect that we've – trend that we've observed kind of in Q2 and that will likely continue further. Maybe just kind of talk about some of the development steps and product initiatives you guys are working on to remove some of the friction of digital retailing versus some of the steps that would otherwise be done at the showroom floor at the dealers.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Sure. Thank you, Lee. Well, first of all, I was very pleased with how quickly our product and technology and engineering teams responded to onset of the pandemic. Deploying home delivery and virtual test drive tools proved to be extremely valuable at the onset and was certainly a big driver to our strong both lead and traffic conversion. I think also when you look at our technology solutions business and the deployment of both Online Shopper and our digital conversation tool, Conversations, not only did the take rate of those increased, but the utilization by dealerships really grew during the period.

And so, we're pleased not only with our own innovation, but how well the dealer community has responded and shifted their behaviors. I think what's telling to me is how dealers are expressing desire to operate with fewer resources and lean more on technology as the second half of the year remains a bit uncertain. And so, I see the utilization of our technology and tools is being something that won't be temporary, but more structural and long-term.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. And then taking into account the roll-off of the discounts and the commentary around kind of what the Q2 normalized average revenue per dealer was in Q2. Off that number, would you guys expect sequential improvements in average revenue per dealer in the second half? And I guess, maybe just talk to the contributors to that, be it incremental Dealer Inspire contribution and FUEL.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Sure, Lee. Actually, if you look at our average revenue per dealer and back out the discounts, ARPD actually grew on a sequential quarter basis which I think shows the fundamental turnaround that we've made with the business year-over-year. And so, we're pleased with that trend as I look out in terms of the growth of FUEL, which did get delayed a bit during COVID, but now is taking a momentum that has significantly higher ARPD, although it'll be a more limited dealer count that uses FUEL, but also our solutions business. The endorsements we've gotten from new OEMs and the continued rollout of GM, all contributes healthily to our ARPD on a go-forward basis.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. Last question. Could you guys maybe just quantify or maybe qualitatively give kind of an outlook for the marketing expense? Would you expect to kind of get back to a more normalized level of sales and marketing expense in Q3, or is it a gradual ramp to incremental marketing dollars?

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

A

Yeah, we do expect to see marketing expense increase through the – through Q3 and for balance of the second half of the year. We are taking measured stuff in terms of how were we investing in that space, but we have already started seeing the SEM environment become more competitive just in this month alone.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. Thank you for taking my questions, guys.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Thank you, Lee.

Operator: Our next question comes from Tom White with D.A. Davidson. Your line is now open.

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

Q

Thank you. Good morning, guys, and congrats to you, Sonia, on the new role.

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

A

Thank you.

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

Q

My first question is just on margins or how to think about margins for the back half of the year. The second quarter EBITDA margins were definitely solid given the revenue declines. I guess thanks to the cost control measures you guys instituted. In the back half, the affiliate payments were done, you're starting to get some General Motors revenue recognition. Can you guys get to EBITDA margins kind of close to 30% exiting this year do you think? Or are some of the investments in marketing ramping up and maybe adding back some head count going to weigh into that margin ramp? And then, I just have a quick follow-up.

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

A

Yeah. So we are – as we look to the second half, dealer discounts have rolled off which is certainly a benefit. You did cite which is accurate, but the affiliate payments will be going away in the second half which was certainly helpful. But we are going to be reinvesting in the business. We're not – obviously the second half environment is a little bit unpredictable in terms of COVID and what the ongoing impact of that maybe. But we are expecting to return to a more normalized level of performance.

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

Q

Okay. And then just I have a follow-up on national advertising. It sounded like you guys are maybe thinking a bit more positively about that revenue line going forward, and Alex I think you touched maybe on ad spend coming off some of the social networks. I guess I was curious about how maybe the pipeline for new vehicle launches or the production lines for new vehicles maybe becoming more active. Is that kind of factoring into your outlook on national advertising or because I think that's a big factor, but I'm just curious whether that's something that maybe will support more resilient trend for that revenue line?

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Thanks, Tom. Yes, National's got obviously a lot of puts and takes and we do make a decent amount of money on new vehicle launches and if those get delayed or pushed out, that could have a negative impact. And conversely, if manufacturers follow through on their launch plans, we can benefit there. There definitely is some pull back from some of the social platforms because of the brand safety and content and that we're finding ourselves on the receiving end of that. Reallocation which is a positive, and we certainly are talking to OEMs about our FUEL using data as a strategy and new product.

So we've got a lot of momentum in it, but I think we're being very cautious knowing there's so much uncertainty and with limited production and limited inventory. We just think the marketing and advertising budgets are going to be cut back commensurate with limited supply. So I think that's why we've got a little bit more of a month to month view on national and don't feel confident giving really any mid-term or long-term guidance on it.

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

Q

Okay. Thank you.

Operator: Our next question comes from the line of Daniel Powell with Goldman Sachs. Your line is now open.

Daniel Powell
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks for taking the question. Maybe just a couple of high level questions here around on the industry. I'm just curious to see here if there anything you saw either in your trajectory of your traffic that you saw throughout the quarter that was tied to consumer stimulus or stimulus coming from the government that could have potentially caused a pull forward here in Q2 for vehicle demand and just seeing any indication of that one-year term?

And then, a question for Sonia, just high level, I know you're talking about sort of measured reinvestment here. But as you kind of think about where this business is today with the accelerating traffic growth, maybe you could just talk to us a little bit about sort of the growth versus profitability tradeoff here just sort of seeing over the next year as you're going to roll? Thanks.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Sure, Daniel. Thank you. Well, look, I think our business is well-positioned because of its digital strength and particularly during a pandemic, you saw that, we had mass consumer adoption and utilization growth in on a much reduced spend and we certainly saw digital conversion to dealers increase as an alternative to visiting the physical showroom and we can measure that. So, we've seen our app showing up less time physically on the showroom floor, but our digital signals in contact and communicating directly with dealers increase.

And so how long that will persist we think is really tied to the pandemic. And – but I also would say structurally we're seeing dealers embrace it, and we're seeing consumers expect more particularly in the area of home delivery, that's probably been the fastest-growing trend for both consumer preference and dealer delivery. I think on the pull forward, I wouldn't put it more on federal stimulus. I think if anything, it's more of a safety boost that we're getting in that we know from our research consumers don't feel comfortable getting back on mass transit or using ride sharing services and the car is an extension of the home in the CDC's recent recommendation that the personal ownership is the safest form of transportation.

I think this a sign of things to come as people really are reserved about going out in public or back on mass transit. I think we are going to continue to advocate for federal stimulus aimed at the retail sector. We think it's the best form of stimulus the government could provide because people still need to get to work, people need to get around and the car is certainly the safest way to do that. And so, we hope to continue to advocate on behalf of the industry for some form of consumer stimulus in the second half.

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

A

And then maybe taking the second part of your question, we delivered tremendous value to our customers this past quarter and that continues to be a focus for us, whether that's investments that we're making in our tech transformation and product development which we think position us well longer-term and are accreted to the overall business or whether it's investments in marketing, which help drive the leads and lead conversion to our dealer customers. The latter in particular I think as you've seen this past quarter is an area where we can flex and we do believe we have tremendously strong organic strength, which is one of the things that allowed us to flex this quarter as we needed to.

Daniel Powell
Analyst, Goldman Sachs & Co. LLC

Q

Thanks so much.

Operator: Our next question comes from Gary Prestopino with Barrington Research. Your line is now open.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Good morning, everyone.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Thank you, Gary.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Couple of questions. Number one, with the decline in dealer customers, these were cancellations on their part, it wasn't kind of a suspension of service saying, hey, let's evaluate this and see three months from now where we go, I just want to get an understanding of how that works? And then the second question related to that, were the cancellations more in the 1 to 2 point dealerships versus the larger dealerships?

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Got it. Well, look, the cancellations obviously accelerated directly correlated to the pandemic. And I think the cancellations were broad and sweeping across all marketing and advertising and not necessarily performance and/or logical discussions around ROI. And I think that's one of the reasons why we're seeing sequential quarter improvement in our selling rate and going into Q3. So in the cancellation mix, yes, Gary, we tended to segment our dealers by franchising independent dealers and we did see slightly more cancellations on the smaller dealer side, but, as you know, the bulk of our revenue and the bulk of our relationships tend to be with the larger profitable franchise dealers who have service revenues that drive profits and just are operating in a much stronger healthier financial state.

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

A

Yeah. And maybe just to add a little bit more color. I think what we saw with the COVID was an initial increase in cancellations and sort of an intent to cancel amongst our dealer base. And what we saw is sequentially each month in the quarter, and frankly, even into July and August since we have some visibility with our 30-day cancellation policy is a steady improvement in that. I think if anything especially with the traffic and improvement in lead that you've seen this quarter, dealers really saw the benefit, this solution, our solution provides for them, right, in a market where there's potentially limited access to showrooms, our folks just aren't as comfortable walking in. They need to conduct research on our site. And as Alex mentioned earlier, there is a growing interest in pursuing more and more of the purchase path in the online channels.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. Thank you. And then, did I understand correctly without these price discounts your average revenue per dealer would have been up year-over-year?

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

A

It would have been up sequentially.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Up sequentially, okay. And – okay. And then, Sonia, lastly, you said the websites were up, were totaled 3,800. Where were you at the end of Q1?

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

A

Yeah. So, we saw growth there.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. But you can't give the number?

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

A

We had a couple hundred ads in Q2.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Couple hundred ads, okay. Thank you.

Operator: Our next question comes from the line of Nick Jones with Citi. Your line is now open.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you for taking my questions. First, are you able to see where the demand is coming from? I guess what I'm wondering is, are you seeing kind of first time car buyers or maybe put another way people who don't have cars and are not buying cars as kind of part of a deurbanisation trend? And then, I have a one follow-up.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

We are seeing strong growth in even – even in particular DMAs like New York, San Francisco, Chicago. We are seeing growth in major urban metropolitan areas, but certainly the growth is pervasive nationally. We're seeing it. There are down pockets in the country. I think truck sales have been a bright spot. And so, I would say the growth is pretty consistent across the country. We do know that due to safety concerns we issued a release in the quarter, Nick, about how people I think previously not considered to own any vehicle have decided to enter the market. So, we do think we are benefiting from a wave of net new buyers that are responding to COVID.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thanks. And then, I guess one more follow-up on the cancellations. I mean, do you expect some of these may come back pretty quickly over time, either kind of in the back half or maybe early next year? And then I guess more broadly when this is all over, are you expecting there to be less dealers in the US or some of these kind of permanently close and not come back?

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

You know Nick, a couple of things. I think, first of all, I think this has been a large marketing experiment for the auto industry to see how dealerships have operated. I think perhaps the biggest expenditure that dealerships now have to rethink is restoring their search spending. As dealers unilaterally cut marketing, cutting off variable performance pay per click marketing happened overnight, but what you did not see is a value from digital marketplace is declined. I think it underscored the durability of third party marketplaces as being indispensable for users and you're not going to be able to buy around them. And so dealerships are rethinking how much marketing do I really need to spend if I can count on these digital marketplaces to reliably generate traffic?

So I do believe that this experiment is being discussed throughout the industry, and again, we're seeing improved selling rates going into Q3. I think on the consolidation side, look, I think with inventory shortages and dealerships that don't have service centers as a profit center, I think they're going to have a hard time in the second half. So I do think there will be some consolidation on the smaller long-tail independent dealers who are solely relying on vehicle sales as their way of life. Fortunately, for us, the bulk of our revenue are with the larger franchise dealers who have very diversified businesses and I think can weather these economic storms far greater.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you.

Operator: Our next question comes from the line of Steve Dyer with Craig-Hallum Capital. Your line is now open.

Ryan Sigdahl
Analyst, Craig-Hallum Capital Group LLC

Q

Good morning, and welcome, Sonia.

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

A

Thank you.

Ryan Sigdahl
Analyst, Craig-Hallum Capital Group LLC

Q

Also this is Ryan Sigdahl in for Steve. Sorry for that. Just to start, Sonia, I think I heard that you said [ph] Dealer Inspire (00:47:43) revenue was flat year-over-year, is that correct? And then, can you talk about the puts and takes there because it seems a bit surprising given kind of a website ads, new OEM programs, market share gains et cetera?

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

A

So, yes, Dealer Inspire revenue was flat year-over-year. I didn't quite catch the second part of your question there.

Ryan Sigdahl
Analyst, Craig-Hallum Capital Group LLC

Q

I think it was basically that even though there was – there were ads et cetera, et cetera it was flat, but you added customers.

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

A

Yeah. So we did. So, I think a couple of puts and takes there. One is we did have some discounting in Dealer Inspire, which is one of the things that is you're not seeing kind of that flow through necessarily of the new customers. Timing is also an issue in terms of when the new customers come online as well. So those would be two of the things that I would point to.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

And the third is that the search engine spending that DI generates revenue there pullback really aggressively because dealers cut all their third-party spending which can have an impact on DI.

Jandy Tomy
Treasurer, Cars.com, Inc.

A

So don't forget that, sorry, this is Jandy, a piece of the DI business is the digital advertising business where dealers will – through us, we will help them with SEO and SEM spending, and that was an area that was pulled back on. So, that's one piece of it, but the other is what Sonia described the fact that we did have discounts that we gave to the website side of the business and DI customers obviously far, far less than the broad-based discounts that we gave to the marketplace customers, but that business continued to grow customers in the second quarter as you saw from the 200 website customer growth that we talked about.

Ryan Sigdahl
Analyst, Craig-Hallum Capital Group LLC

Q

Yeah. That's helpful. And then just on the discounts, have those been completely removed similar to the marketplace or are there any still lingering in July and into August here?

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

A

Yeah, that's correct, they've been removed.

Ryan Sigdahl
Analyst, Craig-Hallum Capital Group LLC

Q

Okay. Then on dealer churn, it's not exactly clear to me, but was there a dealer growth or a churn in July?

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

For Dealer Inspire, there was dealer growth...

Ryan Sigdahl
Analyst, Craig-Hallum Capital Group LLC

Q

I'm sorry, overall business or the core marketplace.

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

A

Yeah. I think for the core marketplace, we are seeing an improvement in sales and churn continues or in terms of cancel rates continue to improve relative to where we were in Q2. But we don't expect a growth in the month of July.

Ryan Sigdahl
Analyst, Craig-Hallum Capital Group LLC

Q

Got you. And I guess when do you expect that to potentially turn? Because it feels like there is more stabilization, greater reliance on digital and all the positive things you talked about the traffic and everything else. So I guess it feels like we're past the worst of the shelter in place in COVID potentially. But I guess why are we still seeing churn today even if there is improvement?

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Look, I think it really is too hard to predict because of so many second order effects that are still happening and surges in cases and continued uncertainty in the economic environment, and so dealers I know are also struggling with inventory shortages. So, I think we're taking a very cautious and measured approach managing the business month-to-month. We are pleased by the improvement on a sequential quarter basis in our retention rates and dealer sentiment because obviously our value delivery signals are improving, but again I think there's larger macro forces here that make predicting that growth in dealer count a little bit more difficult. Certainly, the more websites that we roll out in the second half of the year will contribute in a meaningful way, but at this time, we're not giving formal guidance on that.

Ryan Sigdahl
Analyst, Craig-Hallum Capital Group LLC

Q

Great. That's it for me, guys. Good luck. And I'll hop back in the queue.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Thank you, Ryan.

Operator: Our next question comes from Doug Arthur with Huber Research. Your line is now open.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Yeah. Thanks. Two things, just to clarify on Dealer Inspirer, is it fair to say you expect decent growth in the second half given everything you've already said?

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Yes.

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

A

Yeah.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay.

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

A

Dealer Inspirer was always – I'll just add Dealer Inspirer was always going to be a bit more of a second half story for us as growth in websites ramped up and we continue to expect that to be the case.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. And then just finally sort of big picture, given the growth in leads and traffic year-over-year despite the marketing spend cut, do you feel that you've learned something about marketing spend allocation that might suggest longer-term less spend there. I know you've talked about ramping it back up, but it seems like the channel worked pretty well despite reduced spend. And I'm just wondering if that's got even longer-term implications for how you view that cost category over the next couple of years.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Yeah. I think obviously we're still learning every day, Doug, and I think the marketing experiment is still underway with us as well. And so, we'll be continuing to test and refine our approach. We can see very vividly as people start visiting showrooms, our digital lead counts have grown materially, double-digit growth in lead generation. And so, we know that the offline sales that we weren't getting credit for have now shifted to very vivid digital channels and I think that is improving our value equation with dealers.

And again, I think that's why we're seeing solid improvements in our sales and cancel trends there. I think obviously we're – we continue to enjoy the benefits of having a strong organic channel that's generating a ton of value, but also we aspire to take more market share from competition. And so, we think a measured investment that continues to position us as the market leader is one way that we can shift share of dealers and dollars our way. So, we will be expanding our investments in the second half.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. Got it. Thank you.

Operator: Our next question comes from the line of Marvin Fong with BTIG. Your line is now open.

Marvin Fong
Analyst, BTIG LLC

Q

Good morning. Thanks for taking my questions, and welcome, Sonia. Most of my questions have been asked, but I did want to follow up I guess on the marketing spend. But just more broadly, you've done a terrific job of controlling expenses and I know that you said the majority intended to come back. But should we think about the businesses structurally having a higher margin profile assuming that revenues stay relatively intact and sort of ARPD is tracking well?

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Well, look, I think we've got to continue to invest in some of our growth initiatives, particularly our website business. We've got contracted demand for over 800 websites in the second half of the year, and so we need to make investments to scale and support that customer equation. As you know, Marvin, it's a lower margin business, but it has a good growth profile. And so I think there are certain investments that we're going to have to make. I also mindful that it is an extremely competitive environment and if there are recessionary second order effects that make car sales lower in the second half, there will be more intense competition provide for those sales and to generate traffic and lead. And so I just think again it will be a month-by-month calibration of what's needed, but certainly we need to make deliberate investments into the website business which is scaling nicely, and again, we see solid growth in the second half.

Marvin Fong
Analyst, BTIG LLC

Q

Great. And my follow-up question is just on – drill down a little more on the Nissan that opportunity, could you just remind me like how many dealers they should – where they have and what the incumbent situation is there and how many approved vendors [indiscernible] (00:56:32) on that platform? That would be great. Thanks.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Which platform were you talking of, Marvin, you cut out.

Marvin Fong
Analyst, BTIG LLC

Q

The Nissan, the Nissan...

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

A

Oh, great. Each of our OEM new endorsements that we announced in the quarter have about a 1,000 dealers in their network and those aren't semi-exclusive agreements. So unlike GM which we have a semi-exclusive license to sell, these other OEMs aren't – don't have that nature. So, there will be more competition, but they all have about a 1,000 dealers in their network.

Marvin Fong
Analyst, BTIG LLC

Q

Terrific. Thanks, Alex. Thanks, everyone.

Operator: There are no questions in queue at this time. Mr. Vetter, I turn the call back over to you.

T. Alex Vetter
Co-Founder, President, Chief Executive Officer & Director, Cars.com, Inc.

Thank you all very much for your time today, and we look forward to speaking with you again shortly. Have a great day.

Operator: This concludes today's conference call. You may now disconnect.