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Cars.com, Inc. (CARS)

Q4 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Cars.com Fourth Quarter 2019 Earnings Conference Call. Hosting the call this morning is Alex Vetter, Chief Executive Officer; and Jandy Tomy, Interim Chief Financial Officer. This call is being recorded and a live webcast can be found at investor.cars.com. A replay of the webcast will be available at this website until March 11, 2020. A copy of the accompanying slides can be found on the Cars.com IR website. Following today's presentation, there will be a question-and-answer session with Alex and Jandy.

I'd now like to turn the call over to Jandy Tomy, Interim Chief Financial Officer (sic) [Tui Rademaker, with Clermont Partners]. Please go ahead.

Tui Rademaker

Director, Clermont Partners

Good morning, everyone, and welcome to our fourth quarter and full year 2019 earnings 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 financial measures to the most directly comparable GAAP measure can be found in the financial tables included in our earnings press release and in the Appendix of this presentation. For more information, please refer to the risk factors included in our SEC filings, including those in our annual, quarterly, and current reports. Cars.com assumes no obligation to update any of the forward-looking statements or information as of their respective dates.

At this time, I'd now like to turn the call over to Alex.

T. Alex Vetter

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

Thank you, Tui. Good morning, everyone, and welcome to our conference call for the fourth quarter and full year 2019. On this morning's call, I'll be discussing business highlights from our year and fourth quarter, before providing an overview of our expectations and priorities as we head into 2020. And then I'll hand the call over to Jandy, who will discuss our financial results.

2019 was a [indiscernible] (00:02:08) for our business. We achieved substantial progress on the most important priorities for our business transformation. In the process, we shed legacy structures and exited 2019 with confidence and a momentum that will propel our growth engine throughout 2020 and beyond.

We finished the year with complete control of our dealer customer relationships, significant improvements in our national business, and accelerated growth in our audience and solutions strategy, all of which led to a strong finish in the fourth quarter, where we grew our dealer base by nearly 200 dealers. More than ever, our offerings provide fundamental value for our dealer customers. We have a large and growing car buying audience and our digital tools empower dealers to cost effectively generate sales.

We achieved our success in 2019 through smart investments, tenacious execution, and a continued commitment to strong relationships with our dealer partners and more sustainable ROI. And we did this by taking the high road, by supporting, listening to, and providing a level playing field to our dealer partners. The industry is beginning to recognize our superior value proposition and our dedication to the local dealer community, which gives me confidence that we're well-positioned for 2020 and beyond.

In 2019, we grew our audience market share by a sector leading 33%, driven by record traffic levels. We are now number one in SEO amongst our competitive set, reflecting the strength of our brand, our technical sophistication, and our differentiated product strategy that focuses on delivering high-quality content. I'm pleased that we've been able to consistently deliver audience growth, high-quality leads, and high sales conversion for our partners.

In 2019, we built thousands of new direct dealer relationships by taking back control from our former affiliate owners, giving us direct access to our entire customer base without involvement of intermediaries nor the need to share substantial revenue with them. We have been aggressively striving towards achieving this significant milestone since we became an independently publicly traded company. Later on today's call, we'll talk more about the financial implications and uplift that we will unlock in mid-2020 once the last of the contractual payments are behind us.

This past year also saw an expansion of our leading suite of digital solutions as part of our unique strategy to provide valuable innovations to dealers. The strength of this strategy was demonstrated by our new OEM endorsements in 2019, including our partnership with General Motors, which opened the door for us to sell our website solutions on a semi-explicit basis to over 4,000 new franchise dealers across the country. Finally, we generated significant operating efficiencies through transforming our sales network and technology platform. We are poised to continue realizing the benefits of these initiatives in 2020 and beyond.

Let me now turn to our results for the fourth quarter. I'm incredibly pleased with the continued improvement in our dealer base, which grew by nearly 200 dealers in the fourth quarter. Despite the fact that the fourth quarter is historically the slowest period for sales, this marked the strongest quarter for dealer growth since 2015. Our growth in the quarter was the result of both new customer sales and improved retention.

Our average cancellation rate was the lowest of the year, counter to historical trends, and is attributable to the rapid audience growth, improved sales force effectiveness, and now having direct access to all of our customers. The increases in the dealer base in the fourth quarter and continuing into early 2020 are among the most tangible evidence that our strategy is yielding material results that will drive our top line and, ultimately, category leadership.

And dealer growth isn't the only way we'll drive growth. Dealers want and need our digital solutions as well. Revenue from Dealer Inspire products grew 22% and DI website products alone grew nearly 30% in the fourth quarter. We now have 3,200 website customers at the end of this year, and this is before we all start billing for the website sold under the GM program, which will deliver incremental subscription revenue beginning in mid-2020.

The GM partnership we announced at the end of the third quarter is well underway. With our first dealer enrollment phase now complete, we have contracted for more than 800 GM websites that will begin to roll out this summer, subject to GM's release schedule. Development and launch of these websites are actively underway and revenue recognition builds throughout the second half of 2020.

There is also the opportunity to sign more GM dealers in the future as the program continues. We expect the subscription revenue generated from this partnership to be a key growth driver for the foreseeable future.

Audience growth continued to accelerate in the fourth quarter, with unique visitors and traffic up 32% and 39% year-over-year, respectively. Driven by content and organic momentum, as well as increasingly efficient page search, we continue to close the gap on market leadership, growing our market share from 17% to 23%, and firmly establishing us as the fastest growing player within our category.

Additionally, our market leading SEO performance continues, as we saw 40% year-over-year SEO traffic growth in the fourth quarter. An industry authority, Searchmetrics, ranked the biggest SEO winners and losers of 2019, and Cars.com was the top winner for automotive. On the national front, OEM advertising revenue is stabilizing. Though the business declined year-over-year, the fourth quarter was our strongest of the year and as number of clients returned to spending with us.

We are now driving strong incremental onsite media sales and programmatic open auction revenue, and our upfront commitments from OEMs are generally consistent with last year, further signaling the stabilization of our business. And we're now seeing new momentum with our OEM clients as we seek new ways to partner with them on marketing solutions.

Clearly, advertising from the OEM sector has been volatile and difficult to predict during the last two years across all of North America. But with what we see in front of us right now and our unique strengths, including audience, data, new OEM products, and our auto industry knowledge, we have confidence in our ability to execute and deliver going into 2020.

Finally, before I dive into our expectations and guidance for 2020, I'd like to highlight our efforts to bring greater awareness to our environmental, social, and governance standards. Corporate responsibility at CARS is driven by our dedication to foster culture and business that cares about our people, our customers, our community, and our planet. Upholding the highest standards of integrity, inclusion, responsible business practices is in our DNA.

We launched a new section on our website in the fourth quarter dedicated to ESG leadership that highlights some of the current policies and procedures within our business that support our culture, people, data security, community, and the environment. I invite you to explore this at investor.cars.com/ESG.

Having exited 2019 in a solid position, our focus is now on the execution in 2020. As we look ahead, our focus will be on a relentless pursuit of category-leading traffic and customer growth, innovating best-in-class solutions, and growing our newly launched FUEL, in-market video platform.

We continue to invest in digital solutions for dealers and OEMs that leverage our traffic strength and ultimately translate into stickier dealer relationships that grow ARPD. With the affiliate conversions now behind us, we are able to market our solutions to our entire network of dealers on an unfettered basis for the first time in our history.

Our digitally savvy and dedicated sales teams of dealer advocates are now able to work more efficiently to address the needs of our customers and unlock value that we were not able to under our affiliate model. Combined with our dealer retention strategy, which focuses on introducing dealers to the range of latest tools and technologies, we are very well-positioned to start growing subscription revenue immediately and lapping year-over-year comparisons later this year.

In particular, I'm extremely excited about our launch of PRIZM, our new proprietary reporting dashboard that we recently launched. An important part of our attribution strategy, the tool attracts marketing performance across channels, calculates weighted ROI and product conversion metrics, and delivers group-level reporting and offers automated alerts.

PRIZM allows our sales force to help dealers evaluate their entire marketing engine, establishing us as a true partner for dealer performance. What we see vividly through PRIZM is that Cars.com is driving more traffic to dealer websites than other marketplaces, and Cars.com is four times higher quality than other traffic sources. Our level playing field and commitment to being a dealer partner is becoming more evident, as dealers are seeking true champions of their success.

One of the ways we show our partnership with dealers nationally is through our 20-year support for NADA, the National Automobile Dealers Association, which recently held its annual meeting in Las Vegas. This year we launched at NADA our new in-market video platform, FUEL. FUEL is the unique alternative to traditional television advertising, which is inefficient and shrinking.

Those of you who are familiar with advertising trends are aware that traditional TV is losing viewership dramatically to over-the-top advertising platforms. Only a fraction of the population is in the market to buy a car, but today the auto industry spends nearly $10 billion trying to reach that small population with mass market TV advertising.

In contrast, more than 80% of Cars.com shoppers are in the market to buy a car now. And FUEL enables dealers to run targeted video messages to these highly qualified in-market car shoppers on progressive video platforms. This service was widely recognized as one of the most innovative new offerings at NADA this year and we had many dealers pre-enroll.

As a service that is available only to Cars.com customers, we expect FUEL to positively contribute to ARPD in 2020 beginning in the second half. We plan to provide more commentary during our earnings call next quarter.

By the second half of 2020, many of the pieces of the strategy that we laid out when we went public two and a half years ago will have been fully realized. Primarily because of churn in the first quarter of 2019, we started 2020 with subscription revenue from nearly 1,100 fewer dealers than the beginning of 2019. Fortunately, faith in our strategy and business transformation will pay dividends in 2020 as we leverage our extraordinary increase in traffic, our continuation of increasingly strong momentum with dealer retention, and dealer sales for profitable revenue growth.

Year-over-year comparisons will improve sequentially each quarter due to the beginning dealer deficit, leaving us by the fourth quarter with impressive exit run rates for both revenue and especially EBITDA as we end the year. Our confidence comes from factors such as completion of affiliate payments on June 29, our cut over to the new beta site midyear, and revenue from over 800 presold GM dealer websites.

Our outlook also reflects confidence that comes from our ability to translate market-leading increases in car buying traffic to increased dealers seeking to tap into that growing audience and using our innovative digital tools.

2020 will consist of two distinct halves for both revenue and EBITDA. This is a result of a number of factors including the following: first, we will carry a lower dealer count in the first two quarters before net dealer sales yield favorable year-over-year comps; second, the ramp and revenue recognition of our GM dealer website business that will begin to accumulate once the websites are set live and become billable; third, the ending of our final affiliate payments in June; fourth, significant savings from technology transformation after mid-year cutover to the new platform; and finally, an uptick in ARPD from FUEL in the back half of the year. Momentarily Jandy will provide additional detail around the distinct drivers and assumptions for our first and second half.

For the full year, we anticipate revenue to be flat to down 4% year-over-year. Overall, we anticipate subscription revenue growth to build sequentially throughout 2020, in that we will ultimately exit 2020 with a positive year-over-year revenue growth rate. We will, of course, be monitoring OEM advertising in particular and have built in a cautious downside risk due to the sector's past volatility and exogenous factors to OEM, such as the COVID-19 virus.

We also anticipate exiting 2020 with a positive year-over-year EBITDA growth rate. And for the full year 2020, we expect adjusted EBITDA margins between 25% and 27%. In 2020, we anticipate growth in free cash flow to be flat to up 25% as we capture uplift from our solutions and direct dealer relationships.

I'd now like to turn the call over to Jandy to go through our financial results for the fourth quarter, full year 2019, and additional details around our 2020 outlook, assumptions, and key drivers, Jandy.

Jandy Tomy

Interim Chief Financial Officer, Cars.com, Inc.

Thanks, Alex. Revenue for the full year of 2019 was $606.7 million compared to $662.1 million in 2018. This 8% decrease year-over-year was in-line with our previously issued guidance, which we reiterated during our third quarter earnings call in November. The decline was primarily driven by a decline in dealer count and national revenue, as well as slightly lower ARPD when you exclude dealer websites and related digital solutions.

Direct revenue was up $19.4 million from the prior year, driven by 25% pro forma growth from our Dealer Inspire sales and $52.5 million related to the affiliate conversion, offset by a 1,087 decline in dealer customers. Wholesale revenue of $34.4 million declined $48.6 million compared to the prior year, $39.2 million of which was the result of the affiliate market conversions and $9.4 million related to the client and affiliate dealer customers.

Note that the last affiliate market conversion occurred on October 1, and this marks the end of our wholesale sales channel.

Our national advertising business was down $24.6 million, or 23%, in 2019 compared to the prior year. This was primarily the result of lower upfront commitment and lower incremental sales. However, as Alex said, we saw a healthy improvement in national sales in the fourth quarter, which has continued into 2020. We continue to work closely with our OEM partners to deliver products that meet their evolving needs.

Total operating expenses for 2019 were $1.1 billion compared to $578.2 million for the prior year. As discussed in our third quarter earnings call, we performed an interim quantitative impairment test following a sustained decrease in the company's stock price after the completion of the strategic alternatives review process, and we recorded a noncash goodwill and intangible asset impairment charge of $461.5 million, because the book value of our assets exceeded the estimated fair value. We do not expect this noncash impairment charge to have any impact on operations, liquidity or cash flows, or affect compliance with our financial covenants under our credit agreement. The cash benefit from the deductible goodwill and intangible assets for tax purposes remains intact.

Excluding the impairment charge, total operating expenses in 2019 were $591.3 million. This $13.1 million increase compared to 2018 was primarily due to an increase in costs associated with growth in our solutions business, an increase in affiliate revenue share payments as a result of the early conversions, planned marketing investments, and increased depreciation and amortization due to the reduction of useful life of certain assets related to our technology transformation. And these increases were partially offset by a reduction in expenses resulting from our continued focus on operating efficiencies.

Net loss for 2019 was $445.3 million, or $6.65 per diluted share. Adjusted net income for the year was $104.2 million, or $1.55 per diluted share, compared to $135.3 million, or $1.92 per diluted share, in the prior year. Adjusted EBITDA in 2019 was $167.3 million, or 28% of revenue, which was also in-line with the guidance we reiterated in November. This compares to $227.6 million, or 34% of revenue, in the prior year.

Before I move on to a discussion of fourth quarter financial results, I'd like to take a moment to review our key operating metrics, including our continued successes in audience growth, as well as the fourth quarter growth we achieved in dealer customers that Alex mentioned earlier. Our traffic and audience growth has continued, with the fourth quarter of 2019 being our highest traffic quarter to-date with 146.2 million visits, representing 39% growth year-over-year. Average monthly unique visitors in the fourth quarter were 23.5 million, representing 32% growth year-over-year.

ARPD was $2,136 in the fourth quarter of 2019 and ARPD excluding revenue from dealer websites and related digital solutions from Dealer Inspire was $2,031, down 5% compared to the fourth quarter of 2018. Dealer customers were 18,834 as of December 31, 2019, reflecting an increase of 199 new dealers compared to September 30, 2019. This was driven by higher new customer sales volume and continued improvement in retention rate. Compared to the end of 2018, our dealer customers were down 1,087 as we end 2019 and enter 2020.

Now turning to the financial results for the fourth quarter. Revenue was $152.2 million compared to $164.3 million in the prior year period. This decline was primarily due to a year-over-year decrease in dealer customers, partially offset by incremental revenue from the newly converted affiliate markets and growth in our digital solutions business.

Direct revenue was up $6.8 million, driven by a 22% growth in our digital solutions and $18.7 million of uplift from affiliate market conversion. Wholesale revenue declined $16 million compared to the prior year; of which $12.8 million was the result of the affiliate market conversions and $3.2 million was due to a decline in affiliate dealer customers. As Alex mentioned, our national advertising business began to stabilize during the fourth quarter. On a year-over-year basis, national advertising was down 9% in the fourth quarter and represented the highest revenue quarter for the year at $21 million.

Total operating expenses for the fourth quarter of 2019 were $147.5 million compared to $140.5 million for the prior year period. This increase was driven by cost increases associated with the affiliate market conversion; the lack of a benefit from the amortization of the unfavorable contract liability, which was fully amortized as of September 30, 2019; planned marketing investments; and increased depreciation and amortization due to the reduction of the useful life of certain assets related to our technology transformation. These increases were partially offset by a reduction of expenses resulting from our continued focus on operating efficiencies.

Net loss for the fourth quarter of 2019 was $4.1 million, or $0.06 per diluted share, compared to net income of $9.4 million, or $0.14 per diluted share, in the fourth quarter of 2018. Adjusted net income for the fourth quarter was $42.2 million compared to $34.1 million in the fourth quarter of 2018. Adjusted EBITDA for the fourth quarter of 2019 was $39.3 million, or 26% of revenue, compared to $61.1 million, or 37% of revenue, in the prior year period.

Net cash provided by operating activities in 2019 was $101.5 million compared to $163.5 million in 2018. Free cash flow was $80.2 million compared to $149.3 million in 2018. In 2019, we utilized our free cash flow to repurchase 40 million shares (sic) [$40 million dollars in shares] and repaid $48.1 million of debt, net of borrowings. Cash and cash equivalents were $13.5 million and debt outstanding was $648.1 million as of December 31, 2019. Net leverage at December 31, 2019 was 3.8 times, comfortably below our maximum net leverage of 4.5 times.

As we mentioned on our previous call, we announced in October that we had secured an amendment to our existing credit agreement that resets our net leverage covenant for the remaining term of the agreement. This provides us with increased financial flexibility and capacity to respond to market changes, and our balance sheet remains strong.

Additionally, we have $190 million available on our credit facility, which provides the flexibility for continued reinvestments in the business. In the near-term, our focus remains on deleveraging until we reach our target net leverage of approximately three times.

Earlier on this morning's call, Alex discussed our expectations for 2020. At this time, I'd like to provide some additional clarity around the assumptions of our outlook. As I do so, I invite you to review the bridges that we have provided within the earnings presentation posted on our Investor Relations website this morning.

As Alex discussed, the first and second half are fundamentally different due to several factors. First, remember that we begin 2020 with nearly 1,100 fewer dealers than a year ago and we won't anniversary the stabilization of our dealer base until the second half of 2020. Second, the subscription-based revenue associated with the GM dealer website business will build sequentially throughout the second half of the year, but our investments to ensure a successful rollout and servicing of the more than 800 new GM customers began in the fourth quarter of 2019, and this will negatively impact our EBITDA in the first half of 2020.

These investments are necessary, because the GM business is incremental to the rest of the growth anticipated from the Dealer Inspire business. Therefore, EBITDA margins are expected to be depressed in the first half of the year due to these investments having begun before the GM websites are rolled out and the resulting revenue builds into its full run rate.

In Q4 of 2019, over 800 GM dealers contracted with us for Dealer Inspire websites, anticipated to be rolled out in wave beginning the summer of 2020. Thus, revenue and profit will progressively increase throughout the second half of 2020 and contribute to our strong exit rate in the fourth quarter.

In the second half of 2020, the completion of the affiliate revenue share payments will yield significant savings when they contractually end on June 29, 2020, which is just four months from now. In 2019, these payments totaled $38 million. In 2020, these payments will be approximately $12 million and will be completed in the first half of the year.

Additionally, please keep in mind that in 2019 we also benefited from $19 million of noncash amortization related to the unfavorable contract liability and was included in adjusted EBITDA as a benefit and dampens the year-over-year positive impact on 2020 adjusted EBITDA of the completion of the payments to the affiliates.

Finally, we expect to see an uptick in ARPD in the second half of 2020 as we continue to focus on further extensions of our digital solutions strategy, including our FUEL initiative. Keep in mind that our solutions, products are profitable, but the margins are lower than our marketplace and national advertising products. Therefore, our EBITDA margin percentage will be impacted by a shifting revenue mix as DI and FUEL grow at a faster rate and become a larger portion of our total revenue moving forward.

And lastly, please remember, the OEMs to which we sell our national advertising products could be impacted by repercussions from the COVID-19 virus, which could lead to a scenario that results in the low-end of our guidance range.

And with that, I'd like to turn the call back to Alex for some closing remarks.

T. Alex Vetter

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

Thank you, Jandy. As we close the year with momentum and a solid positioning for 2020, it is extremely gratifying to see that the execution of our strategy has created a platform for financial growth and market leadership. Our dealers and industry are beginning to recognize the quality of our solutions and the depth of our local dealer relationships, and we're on a strong competitive position to ramp in 2020.

And with that, I'd like to open the call for your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Tom White at D. A. Davidson. Your line is open.

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

Q

Good morning, guys. Thanks for taking my question. One on ARPD, if I could. It looks like kind of, excluding the Dealer Inspire stuff, it was down 5% in the quarter. Could you just help us understand a bit more what's happening there? It seems like there should be a number of tailwinds to benefit that stat, like some of the big urban markets that have been opened up by the affiliate conversions and some of the new products, like Social. So I guess presuming I'm right about those tailwinds, kind of what's sort of offsetting them?

And maybe just a bit more color about why you expect that ARPD to pick up in 2020, and I think you said that, Jandy, in your comments. And kind of when – is that also a second half weighted development or can we expect that sooner? Thanks.

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

A

Thanks, Tom. Certainly, the dealer mix is the biggest piece I want to point to you for Q4. Keep in mind that the final affiliate conversions we executed were from the smallest markets. Gannett, if you look at Gannett's market footprint, yes, they've got like two large markets, but the vast majority of dealers are coming in through what we classify our C or D markets, which our rate card skews by market size, right? So the smallest markets like Muncie, Indiana are fractional in value compared to Chicago or L.A.

So, we brought over roughly 2,000 dealers into our mix in the fourth quarter, which I think has more to do with the ARPD drag you're mentioning, because we do see more upside in ARPD. Our product solutions upgrades are taking form. This is before we even launched things like FUEL, which we think will really bolster your question on ARPD. Yes, we think it's a second half uptick as our solution strategy ramps. Keep in mind, we don't have the 800 dealers that have already signed up for the GM Dealer Inspire website platform in our dealer count nor ARPD calculations yet, and so we do see strength in that driver in the second half of 2020.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Yeah. And just to put a finer point on it too, Tom. What you're remembering are the larger markets that we converted in 2018. So in 2019, they were kind of fully in already. So from a year-over-year perspective, there wasn't tailwind there. It's just these new affiliates that we did in 2019 that Alex is pointing to. And some of the pressure also is from kind of the mix of up-sells and downgrades. So we are experiencing – I think we've talked about it on the last couple of calls – pressure from dealers canceling some of the legacy products, more the display type of products, and that is being offset in part by Cars Social.

Cars Social launched two years ago now I think it was and we certainly are still seeing growth there as we continue to evolve the product. But we're kind of on the cusp, we're right at the beginning of these new products that we're about to launch. FUEL, in particular, right, and then this kind of – I won't call it pent-up demand with

GM, because it's already been sold. It's a matter of actually just rolling it out. So those two things are coming and they will really be more second half events from an ARPD and revenue perspective.

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

Q

Okay. Maybe just one related follow-up. Any comments you can make on just sort of pricing for the core listings product? I understand maybe dealers canceling some of the legacy stuff, but what about just core listings. How are those kind of renewal discussions going with dealers? Any pressure there?

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Yeah, there's always a little bit of natural pressure with churn, where dealers that we've had for a long time, we've had the ability to up-sell and dealers coming in come in at a more base level. But when you look at the average pricing of dealers that cancel compared to dealers that sign in, it isn't a very wide gap. And, frankly, over the last – I don't know – call it four months, five months, six months, we've been very focused on price, locking in contracts longer, focus on less discounting, and we're feeling very good about where we are here as we start out 2020 from a pricing perspective.

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

A

And certainly the traffic trends are the wind at our backs there, right? Our value delivery is improving, which makes our pricing more attractive.

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

Q

Great. Thanks, guys.

Operator: Your next question comes from the line of Lee Krowl with B. Riley FBR. Your line is open.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Great. Thanks for taking my questions. First, just kind of want to start off on a high level one. Obviously, as we sit here earlier in the year, I just kind of wanted to get baked into the drivers that you outlined, what is the overall industry assumptions that build up to this, the flat to down 4% revenue assumption? Obviously, you guys are part of an industry that's kind of flat to down-ish, but just curious to your thoughts on the overall industry and how that impacts guidance for the full year.

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

A

I think if there is a macro factor in our guidance for 2020, it would be the uncertainty and volatility on national advertising, whereas our dealer fundamentals we see as being extremely strong and completely turned around from where we were in 2018 and even 2019. And that's where we've been focused. That's been our primary core marketplace. And I would also say, technology solutions is still in its infancy. Dealers are increasingly turning to marketing technologies to automate and remove operating costs from their business, and I think we're really well-positioned there.

So I think the growth in our solution strategy we see is another big tailwind for the business. I think national, we're taking a more cautious outlook for 2020 just because of the uncertainty and the impact on the market, but the rest of the business we see opportunity.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. And then, I think it was on the last call that you highlighted there were, I believe, two to three other OEMs that were in the pipeline for Dealer Inspire solutions. Is there any sort of GM-like assumption built into the guidance for any of these OEMs coming online?

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

A

There is not. Obviously, GM being the largest, that's why we've called it out, but there is no material step-up in our trajectory due to any OEM additions in 2020.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. And then the last one for me just on the GM relation specifically. Is there a set go-live date or is that at the discretion of General Motors? Just trying to put a finer point on what it means for revenue in terms of when you start to recognize.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Yeah. Yeah. So, right now, there is a schedule, there is a plan and it is this summer. So, the website's beginning to roll out this summer. And just to make sure that piece of it's clear, there will be a schedule where the websites will roll out. GM is assigning each partner how many they can roll out in each wave roughly monthly. And so, we'll roll out one tranche one month and we'll get the revenue the next month, and then the following month we'll roll out another tranche and you'll get the revenue for what you've rolled out thus far, right?

So, that's the build. But, the schedule is in GM's hands at the end of the day. So, that piece of it, we have a schedule right now, we're certainly working with them to try to get more and faster. But as of right now, the expectation in the schedule would be this summer.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. Thanks for taking my questions, guys.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Of course. Thank you.

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

Daniel Powell
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you. Two questions, if I could. On the first one, just wanted to get a sense for how dealer growth in the core product, so kind of excluding Dealer Inspire for a second, compared to the lead growth that you saw in the quarter and the 40% growth in SEO traffic that you saw in the quarter?

And then secondly, just want to get a sense of sort of where these investments behind Dealer Inspire and that product are coming in sort of relative to your expectations in the back half of the year. Was there a sort of ramp in conversion of GM dealers that seems to be driving that kind of above-expectations? It would be helpful to hear. Thanks

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

A

Thanks, Daniel. Well, first of all, on the dealer growth side, we're seeing a lot of positive momentum. Obviously, I go back to 2018, we were down close to 2,000 dealers. 2019, we cut that loss to 1,000 and including growing dealer count by 200 dealers in the fourth quarter. And 2020 is starting off on positive footing. That's just on the marketplace side before you include the great work we've done on GM and organic growth in website sales across all OEMs. So we feel pleased about that, and I would say largely attributable to that would be our strong traffic performance.

The majority of our traffic growth is coming in through SEO, so it isn't traffic that you can buy elsewhere, and dealers are recognizing that this is some of the highest quality traffic that they can convert. We've been very focused on improving lead quality this year and are getting strong feedback signals from dealers that that is working. And so the traffic growth doesn't correlate to lead growth, right? We're always going to have much higher traffic growth than lead count growth, but the correlation of the quality signals and traffic and leads is very vivid.

I'll also point that in the quarter we made the announcement of launching PRIZM, which gives dealers a better diagnostic of their total backend performance of not only Cars.com, but all marketplace participants. And what we see very vividly in the data, and this is on a large sample size of over 3,000 dealers, is that there was no marketplace driving more traffic and quality traffic in the dealer websites than Cars.com. And dealers consistently report that traffic is being the highest quality conversions that they can get their hands on. And so, those quality signals we take very seriously and we're focused on continuing to improve them, and we see positive trends.

On the DI investments, look, we're largely having to add head count there, and the margin profile of our solution strategy mutes some of the strong performance in the business, because we've got to ramp head counts before we recognize revenue. Our head count ramp is much lower than it was last year. But nonetheless, when you onboard 800 dealers, the production effort alone and the support that we have to provide them is something that we have to get right, and our goal is to get all inner dealer successfully launched and create a lot of positive momentum in the dealer community for GM dealers, who I think – the first wave, I think a lot of dealers took a wait and see approach, and the 800 that made the switch are really brave innovators and are focused on growth. And so, we're going to be successful with those 800, and that's going to bring more and more the GM dealers in the second round our way.

Daniel Powell
Analyst, Goldman Sachs & Co. LLC

Q

Thanks. Appreciate the detail.

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

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Thanks. Good morning. So just kind of piggybacking on that question, Alex, it sounds like you think there's still a decent amount of GM dealers who have not made a decision yet. I guess of the 800 you have, what is your sense sort of as to market share there vis-à-vis the other providers?

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

A

Thanks, Steve. Certainly, we see the data that shows that nobody gained more share than us in the first round, so we were the market leader in terms of new dealer adoption. I think, obviously, the market is aware that CDK, the incumbent who owns the majority, just sold the business. And so, I think that will move more dealers to want to consider alternatives of companies that are very focused exclusively on this segment. And so, I think that will only open more opportunity up as the second wave opens up.

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

And what is your sense – maybe I missed this, but maybe rough numbers, percentage that have decided and percentage that have yet to decide?

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

A

I think it was less than a quarter, for sure, and that's taking 800. So, I think it was sub 20% of the dealers actually elected to make a change. But, Jandy, we should follow-up and make sure [indiscernible] (00:42:33).

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

I'm happy to follow-up. Like Alex said, we know that we were the leader of the three new providers as far as taking dealers over, but there is still a good number that sort of defaulted and stayed with. So, if you didn't make a decision to move, you stayed with CDK.

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

A

Correct.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

So there is still nice opportunity for us later this year when the enrollment window opens back up for us to go back after that group.

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. Okay. Nice to see the net dealer and in the quarter, I guess, I'm wondering if you're willing to sort of share what you saw in January and how February is looking. And maybe is that something you would anticipate sequentially continues to add dealers throughout the year?

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

A

Well, look, I'll point to a couple data points. First and foremost, the very vivid improvement in our cancellation performance, in 2019 we had cancellation rates as high as 4%, and in the fourth quarter we got those numbers down closer to 2%. And that's been a durable improvement in our retention rate.

In Q4, we only had two months where we were free from affiliate distraction, and that's not surprisingly that that produced our strongest net growth of the year, in that our sales team had no conversion work to do. And we're seeing some of that improvement in our sales pacing starting January and February as well.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Yeah.

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

So have you been positive, I guess, quarter-to-date or would you prefer not to share?

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Yeah, we are positive quarter-to-date. So, I would say we're certainly feeling good about the stabilization of the dealer base.

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. Okay. Thank you.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Thanks, Steve.

Operator: Your next question comes from the line of Doug Arthur for Huber Research. Your line is open.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Yeah. Thanks. Alex, I think you touched on this, but when the next wave and window opens for the GM dealers, are some of the costs that you built up the staffing, will you get some operating leverage on that on the next ramp in dealer adds, or will there be another wave of investment accompanying that?

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

A

Doug, thanks for asking. Yes, I think 2020 is a year where we're not seeing the leverage in the financials, but I can tell you that we absolutely see it from scale, right? So, we're making the investments in 2020 because we see a big opportunity not only with the existing GM dealers, but future demand. But where we're getting the leverage is in our production cycles. We went from, call it, a 90-day development cycle to launch a dealership down to 60 days. And then our cost-to-serve, we continue to see operating improvement in those KPIs as well in terms of being responsive to dealer support.

So we're seeing it, it doesn't appear in the financials in 2020 just because of the timing of the expense early and the revenue late, and that's, again, points to our first half/second half dynamic that you see in our financials. But we actually do see good leverage in that business as we model the business out over the next few years.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.
A

Yeah, absolutely. I mean, the big investments really are starting now. If you look at the numbers last year, last year DI added 700 website customers for the full year 2019. This year we continued to grow kind of with the excluding GM business, and then you add in the GM business on top of it. So we have some significant investments that we started last year and are continuing into this year. So, as we enroll and bring on more GM dealers incremental to this original wave – or this initial wave, there will likely be some investments, but not to the magnitude of what we're doing right now.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC
Q

Okay. And then lastly, Jandy, you threw out a lot of numbers on the impact of the affiliate conversions for both the year and the fourth quarter. I guess, just focusing on the fourth quarter, can you just run through those numbers again, sort of what was incremental versus the wholesaler you lost? And just trying to get a sense of what the uplift was.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.
A

Yeah, sure. So, let's see. So the net revenue impact on the fourth quarter was $2.7 million of incremental revenue in the fourth quarter. The thing to keep in mind, which I think there's a lot of confusion out there in the market, is around the affiliate revenue share, that expense line item. So in that line item, you'll see in Q4 we had $11 million of expense and that's $11 million of payments that we made in total, in sum total to all of those former affiliates. And what we didn't have, importantly, in the fourth quarter is the benefit from the amortization of the unfavorable contract liability.

So that's the $6.3 million of benefit that's been running through our P&L and being additive, included in adjusted EBITDA is that noncash benefit that we've had every quarter since 2014, but it ended in Q3. So Q3 you would have seen $5 million of affiliate revenue share expense, but we had $6 million in there as a benefit, a noncash benefit. So truly that run rate was $11 million in Q3 as well. So that's the piece I think that a lot of people fail to realize, is that that would be the other moving part to keep in mind as we go forward.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC
Q

And the affiliate share expense you said will run out by Q2, so is that correct?

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.
A

That's right. That's right. So we're expecting it to be about $12 million, so $6 million in Q1, $6 million in Q2, and then, zero starting July 1.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. Thank you.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Sure. Thanks, Doug.

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

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks for taking my questions. I guess as you talk to dealers and you win dealers back, what are you learning about how they wanted to play their budget as you shift into some other products like FUEL IMV? Is there less emphasis on kind of the core referral network through Cars.com and more towards winning leads through kind of off-platform channels, for the lack of a better term?

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

A

Nick, thank you. No, absolutely, dealers are wanting to tap into strong organic sources of traffic. I think probably the number one reason the dealers are coming back to Cars is realizing that when they subscribe to us, they're not necessarily competing with themselves in open search and other channels where they currently spend more of their budgets. I see more progressive dealers realizing that they're not going to buy around these marketplaces. But then, within the marketplaces, they're being much more shrewd about picking winners and losers and those that are advocates for their business versus more prey on their business for gain. So I think we're seeing strong momentum in 2020 in dealer count because of that commitment to dealer advocacy and keeping the dealer whole.

I think the solution side is incremental. It isn't a switch for us and many of the things that we're doing on the solution side leverage the strength of our marketplace. So, for instance, FUEL is only available to Cars.com dealers. You won't be able to buy our video offering unless you're a subscriber to our marketplace. And so, I think that's part of the benefit of our differentiate strategy is that we're working with the dealerships to optimize their business no different than we're helping put their listings on Facebook Marketplace. And I think the smart dealers are recognizing there's one partner out there that's helping them beyond just listings.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Great. And one follow-up. We saw Ansira acquire CDK Digital Marketing business. I mean, do you expect the agencies to maybe lean into auto tech offerings to try to combat some of the things you're launching, like FUEL IMV?

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

A

Look, I think agencies are always skating around the auto industry. What I'll tell you is that specialization is being required to be effective in this category. And so while many agencies have horizontal platforms and businesses and offer solutions, what we're finding is that the vertical focus and the specialization in auto is our competitive advantage. Video has been out for dealers for years, but the same problem with online video is with traditional video, it's largely untargeted to audiences that are in the market to buy. And so the benefit of our platform is that we're leveraging the strength of our consumer audience and driving greater efficiency than these generic solutions provide.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Thanks, Nick.

Operator: Your next question comes from the line of Marvin Fong of BTIG. Your line is open. Marvin, you may be on mute.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Marvin, are you there?

Marvin Fong
Analyst, BTIG LLC

Q

Sorry, my apologies. I was on mute. Thank you for taking my question. Most have been asked, but just on the uptick in marketing and sales expense in the fourth quarter, you said that that was planned. Could you dig a little more into what that spending was on?

And then also on the cost side, I know that several items are going to be rolling off, but you also mentioned that some technology cost associated with the beta test will also be rolling off. Could you kind of help quantify how much that might be?

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Yeah, yeah. So, some of the marketing investments is the spend from kind of our normal program, brand spending. You'll remember that we started the year off with the anticipation that we were going to spend an incremental $15 million in marketing this year. And with the successes that we saw within SEO and also the efficiencies that we gained within our paid program generally, we didn't need to windup spending that $15 million, that we achieved the dramatic success in traffic without that spend. So, some of that is spending. The other piece of it – there is a piece related to DI, so the growth in DI with GM and with the rest of the businesses just with kind of the compensation within the sales force for that business.

And then the other question was on cost saves and cost throughout the year. Certainly, I'll just take a moment to relish in the savings that we found last year in 2019 and realized both from the sales transformation, product and tech. As we started the tech transformation, we saw some nice savings there as well, as well as other places throughout the organization. That was realized in 2019.

As we look forward to 2020, we do have incremental cost saves associated with the tech transformation, and those are coming really in kind of the back half of the year. And the full run rate is the $10 million that we've been talking about, but specifically in this year, it's about $4 million based on the timing of the contracts that we'll wind down as we bring up the new contracts for the new structure.

Marvin Fong
Analyst, BTIG LLC

Q

Terrific. Thanks. And just a second question on FUEL, so looks like already your guidance embeds some cost, as well as revenue benefit. Could you just kind of drill into that? You've said you already had customers sign up for it. Is your guidance only embedding sort of the business you've won already or are you anticipating further wins contemplated within your guidance? And if you could just also just kind of – oh, go ahead. That's the end of the question.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Sorry, Marvin, I didn't mean to interrupt you. So, it is early stage, right. We have customers that have enrolled in FUEL. We've, obviously, been through beta test with the product, but it is sort of pre-revenue stage. Our outlook around this product is great I'll say, but we're also very cautious this year, because we are just rolling it out. So, we've got assumptions in the budget beyond what we just pre-enrolled, again, with the positivity around this product and our expectations for success there. But it is relatively small for the full year.

The costs associated with it – and maybe you were asking about costs, some of it is certainly people-oriented, so the team that's needed to support the growth in this new product and launch of this new product. But the majority of it really is the media costs associated with it.

Marvin Fong
Analyst, BTIG LLC

Q

Great, thank you. Thanks, Jandy. Thanks, Alex.

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

A

Thank you.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Thanks, Marvin.

Operator: Your next question comes from the line of Daniel Kurnos of Benchmark. Your line is open

Q

Hi. This is [ph] Chad (00:56:10) on for Dan. Could you talk about what the lead volume growth was in Q4? And can you give us a sense of how new traffic is converting to leads or what you're doing to help convert that strong traffic into a lead volume growth? Thanks.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

From a lead volume perspective, it isn't the number that we are going to disclose. Rather, I'll point you back to the fact that we're very, very focused on the quality of the leads that we're generating, and the connection and value that we're delivering to our customers, right? I mean, at the end of the day, that quality is evidenced by the improvement in our cancellation rates and retention rates and the growth in our sales rate. So that would be the evidence of the efforts that we've made to really take a very close look at where we're generating traffic, how much traffic we're generating, and how that's converting over through to in connecting to our dealers.

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

A

Daniel (sic) [Chad] (00:57:01), I'd also encourage you in any of your dealer market checks, I think what we're finding back is dealers are saying overwhelmingly nobody's doing a better job than CARS. So, our strategy is being played back to us by the dealer community and the focus on quality is what they're asking for and we're delivering.

Q

Great. Thanks.

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

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Thanks. Just one follow-up for me. Just in kind of given the guidance, the cadence of which would suggest that Q1 revenue would be lower than Q4 by some amount, I'm just kind of trying to figure out the puts and takes of why that would be. The dealer count's on the upswing. I think DI would be incrementally higher. What would cause the downdraft in Q1 relative to Q4?

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc.

A

Yeah, yeah. Some of it is the ARPD softness and the other piece of it is national. So national, again, we're feeling good about this business and what we're seeing in conversations. And the improvement in the fourth quarter still yielded declines year-over-year. The other piece of it is, national, as it's getting back to more of a stable place, is a bit seasonal. So, it's hard to see, I know, in our recent results, given what's happened over the course of the last year or five quarters. But typically national revenue is higher in the back half of the year, so it's a normal seasonal trend to see a little bit of a back step in national from Q4 to Q1. And we're also cautious about that line of business. And like I said, improvement in Q4 was still a 9% down. We saw a nice trend in December. We've seen nice trend in January. We're not at double-digit declines anymore, but that would be the other piece of it.

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

A

Steve, this is Alex. I'd just also point. We're starting 2020 with a much lower dealer base than we were in 2019, and so it will take us some time to lap that. But with the positive trend in dealer count in Q4 and that persisting in Q1, we see line of sight to overcome that gap in the first half of the year, which makes the second half of 2020 so appealing, the top line growth and, more importantly, the EBITDA expansion in the second half as affiliate payments wind down in June. So, those are the big drivers.

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC Q

Yeah, I understand the year-over-year. I'm just more thinking as it relates to Q4. So, it sounds like ARPD – I mean, do you have some visibility or line of sight to that improving in Q2 onward then or is it strictly sort of a matter of making the bet on getting more dealers back in the fold?

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc. A

It's really around product. So, yes, dealers are one piece of it. Also with the focus on larger dealers from a new sales perspective, to get those larger dealers with the higher rate card in. But it's also rolling out of new products and solutions, right, so the continued growth at DI and the rollout of FUEL and the ramp-up of FUEL as the new products and solutions and pointing back to our solution strategy. So it's more of a back half of the year, ARPD growing in the back half of the year as a result of those products in particular.

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC Q

Got it, thanks.

Jandy Tomy
Interim Chief Financial Officer, Cars.com, Inc. A

Thanks, Steve.

Operator: And there are no further questions in queue at this time. I'll turn the call back to Mr. Vetter for any closing remarks.

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

Thank you, everybody, for joining us today.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.