05-Aug-2019

Cars.com, Inc. (CARS)

Q2 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Cars.com Second Quarter 2019 Earnings Conference Call. Hosting the call this morning is Alex Vetter, Chief Executive Officer; and Becky Sheehan, Chief Financial Officer. The call is being recorded, and a live broadcast can be found at investor.cars.com. A replay of this webcast will be available at this website. 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 Becky.

I'd now like to turn the call over to Jandy Tomy, Vice President of Investor Relations.

Jandy Tomy
Vice President-Investor Relations & Treasury, Cars.com, Inc.

Good morning, everyone, and welcome to our second quarter 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 found on slides 2 and 3 of 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 second quarter 2019 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. Cars.com assumes no obligation to update any 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, Jandy. Good morning, everyone, and welcome to our conference call for the second quarter of 2019. Before going into details of our second quarter results, I'd like to take a moment to cover our other announcement this morning. Today, we announced that we concluded our strategic alternatives review. In line with our commitment to transparency, we have separately issued a detailed chronology with substantial disclosure about our extensive and comprehensive process. It's been 10 months and involved more than 25 parties.

This process did not yield actual options for a sale of the company. As a result, we determined that the best path forward is to execute on our standalone strategic plan and continue to evaluate opportunities to create shareholder value. You can read about the full breadth of our sales process in this morning's public release. But now, I'd like to talk to you about our business where our focus remains.

In parallel with the strategic review process, we were also able to take share and grow audience, stabilize our dealer base, negotiate and complete the last of affiliate conversions and we remain on track to achieve more than $30 million of annualized cost efficiencies. Key performance metrics in the second quarter reinforced confidence in our strategy to expand from a listings-only model to a digital solutions platform provider.

Our differentiated proposition offers dealers a greater array of sales tools and a better user experience for car buyers. We believe that this strategy will propel us to sustainable market leadership over time and that we are best positioned among all our competitors to successfully execute this strategy. Although we've been executing our strategy at a rapid pace, the upward trends are slower than anticipated as we navigate challenging industry dynamics.

Our plan to achieve sustainable market leadership is moving in the right direction with many critical operating metrics showing clear progress. We have talked extensively about our investments designed to grow audience, increase value and ultimately improve retention and dealer count. This approach is yielding encouraging results. Positive momentum has continued for overall site traffic, SEO and quality lead delivery. And we are very excited to announce that we've delivered growth during the second quarter in direct marketplace dealers, the most prominent of our dealer customers segments.

In particular, direct dealer growth reinforces our confidence in our strategy, execution, and vision despite the fact that progress has not translated to projected levels of revenue in 2019. Our products and solution capabilities distinguish our go-to-market approach from competitors, and our dealer customers are reacting positively to our improved trends, evidenced by dramatically improved retention rates.

While affiliate dealer cancellations have accelerated, I'm excited to announce that we have successfully negotiated the conversions of our remaining affiliate markets a year ahead of schedule. We will explain further about the opportunity to deliver value to dealers in these territories directly and increase our ARPD. Though we recognize that we still have some challenges to tackle, I am pleased to be able to further describe the significant operating cost reductions and other achievements across the business.

Since 2017, we have been diligently working on restoring growth to our audience, the fundamental deliverable of entering marketplace business. We've mastered traffic growth for 19 consecutive months. This growth has been driven by our product innovation, marketing investments, as well as our superior SEO. In the second quarter, we achieved 16% growth in traffic with 13% growth in unique visitors. We are taking market share throughout 2019.

One of the differentiators of our business from the competitive set is the strength of our leading brand and the enviable strength of our organic traffic, notably organic sources of traffic comprise three-quarters of our visits in the second quarter, a testament to the strength of our brand. Cars.com is truly synonymous with car shopping.

In addition to brand strength, which yields traffic at significantly lower customer acquisition costs, the diversity and balance of our traffic sources is a key competitive advantage of our business. Underlying our traffic growth is the strength of our SEO traffic, which grew 51% year-over-year in the second quarter, a further acceleration from the 49% growth that we saw in Q1. We continue to experience strong growth entering the third quarter of 2019.

Our tremendous success with SEO is due to our work over the past two years. The Google algorithm change on March 12 definitely penalized others and provided us further improvement in our market position, enhancing the trend that we've seen over the past year. It is a testament to our dedication to quality, original content, and user experience that also enhances our overall customer proposition.

We've been consistently owning the highest SEO ranking position since March. SEO is a rich source of organic traffic and leads for our dealer customers, and a cost-effective way for us to deliver value. As you know, we have a three-part strategy to increase dealer count: traffic and lead growth, product innovation, and our new go-to-market sales structure.

At the end of last year, we embarked on a bold, new transformation process to align with our go-to-market solutions strategy, better serve our customers, and improve our dealer count. We have focused our efforts first on reducing churn, and increasing contact velocity, the quality of our customer interactions, and packaging of our products to increase retention.

In addition, we are making investments in marketing to continue to drive audience growth, leads, and conversions to sales. Our marketing investments led to 9% growth in leads in the second quarter, and yielded higher quality leads that our dealers can more easily convert to vehicle sales. Users are recognizing our improved lead quality in combination with our achievements in traffic and audience growth, all of which are vital components to our overall strategy. These initiatives are translating into dealer retention because we're focused on maximizing gross profit for our dealer customers.

The December 2018 Sales Transformation led to higher dealer cancellations in January and February. With the Sales Transformation now behind us, we have demonstrated that our strategy has significantly improved dealer retention. We realized net growth in both May and June with the most significant segment of our customer base, our direct marketplace dealers.

Both sales and cancellations improved in the quarter. And in May, our cancellation rate improved dramatically; and June was even better. These improvements in cancellation trends are evidence that our three-part plan is working: continued traffic and lead gains, product improvements like AutoCorrected and Social Sales Drive, and our modernized and best-in-class sales force.

Our first priority has been the stabilization of our dealer base, and I am proud of all the strides that our teams have made in support of this strategy. While we continue to focus on maintaining these positive trends, we are also working diligently on our solution sales. We continue to work with OEMs to gain the necessary certifications and endorsements to allow their franchise dealers to subscribe to our products on a preferred basis, an even bigger opportunity for us now that CDK has announced their intention to exit their digital solutions business.

And finally, by gaining control of all geographies across the country, we are now able to execute our sales strategy in a cohesive way, ensuring dealers in every city have full access to our complete suite of dealer products. Since our spin two years ago, we have been clear that affiliate conversions are our top strategic priority. Converting these territories to direct control allows our sales force to directly support the dealerships in these important geographies. Gaining access to these markets allows us to deliver more value and drive profitability in some of the nation's largest and most attractive markets in a much more efficient way.

Today, we announced the final pieces of the execution of this strategy, the early conversion of both Gannett and Tegna. This means that all affiliate conversions will be completed by the fourth quarter of 2019, one full-year ahead of schedule. And importantly, these conversions are expected to contribute revenue of approximately $9 million in 2019. The profit impact is slightly negative in year one due to the increased sales costs and payments we need to make to secure early conversion. Once we complete the payments for these conversions in the second half of 2020, we expect more than $50 million of annualized free cash flow uplift. We're excited by what's to come and we look forward to serving 100% of our customers directly.

Our experience with the dealer business provides us with a playbook on how we can resolve continued softness in national advertising revenue. As we've been talking about for the last year, OEMs are shifting spending to programmatic and cutting advertising to reduce costs, but not all are necessarily improving sales. Many OEMs are focused on traffic directed to their brand sites as opposed to reaching consumers where they prefer to shop. As a national automotive marketplace, we attract a wide targeted consumer audience who are actively in market and provide tools to direct those consumers to our OEM partners.

Upfront sales for 2019 were significantly lower than last year. As we progress throughout this year, we are selling more to auto adjacencies, growing our programmatic offerings and launching new products. But these are not yet enough to offset the lower up fronts in 2019. We continue to work hard on the recovery of this business. And although we anticipated continued decline throughout 2019, at the start of the year, the declines are steeper than we anticipated.

This is an overall challenging environment, giving a shift to the ad spend to Google and Facebook and to programmatic buying. Addressing this challenge requires a turnaround plan. Similar to our strategy with local dealers and the success we begin seeing in the second quarter, we are adapting and developing OEM-specific solutions that deliver new car sales from our growing valuable audience and leveraging our data to help OEMs reach in-market shoppers more effectively.

I want to take a moment to highlight the significant efforts and progress we've made across the organization, seeking and implementing ways to operate more efficiently. These efficiencies have been found across every department in the company. In particular, our Sales Transformation was fully implemented in December of 2018 and corresponding cost savings began in early 2019.

The technology transformation is progressing on time and on budget and is already yielding savings as we shift away from our data centers to a cloud-based environment. We kicked this project off in the first quarter with the goal of building a flexible and scalable technology infrastructure that will be more geared towards development and require less maintenance time and expense. We are on track to finish the project in 2020 as we conveyed at the onset.

Within cost of revenue, marketing, and general and administrative departments, we have also found vendor savings in addition to head count-related savings. Our focus is to be efficient with our spending and the investments of our time. We will continue to drive further efficiencies to optimize the business.

And at this time, I'd like to turn the call over to Becky.

Becky A. Sheehan

Chief Financial Officer, Cars.com, Inc.

Thank you, Alex. Revenue for the second quarter of 2019 was $148.2 million, compared to $168.5 million in the prior-year period. The decline was primarily driven by fewer dealer customers and lower national advertising revenue. Direct revenue was down $4.3 million year-over-year, driven by softness in dealer count. This decline was offset in part by a $6.4 million revenue uplift from affiliate market conversions and $4.5 million, or 31% growth from our dealer-inspired solution sales. Wholesale revenue of $14.1 million declined $7.6 million compared to the prior-year period. Excluding affiliate conversions, wholesale revenue was down $2.2 million, driven by a 9% decline in affiliate dealer customers.

Our National advertising business was down $7.9 million, or 29% in the second quarter, compared to the prior-year period. While audience growth increases our advertising opportunity, we are also taking a number of steps to improve our current product offerings and introduce new solutions. In addition, we have hired a new leader for our national sales business, who we expect will further help us accelerate our shift into more data-driven solutions.

Shifting to these new products will take time. We continue to be cautious about this channel and project a decline in our national business in 2019. Total operating expenses for the second quarter of 2019 were $147.2 million, compared to $144 million for the prior-year period. This increase was driven by a $6.1 million increase in nonrecurring costs and a $3 million increase in depreciation and amortization, partially offset by operational efficiencies in product, technology, and sales.

Net loss for the second quarter of 2019 was $6 million or $0.09 per diluted share, compared to net income of $12.7 million or $0.18 per diluted share in the second quarter of 2018. Adjusted net income for the second quarter of 2019 was $20 million or $0.30 per diluted share, compared to $34.3 million or $0.48 per diluted share in the second quarter of 2018.

Adjusted EBITDA for the second quarter of 2019 was $43.5 million, compared to $57.3 million for the prior-year period, driven by a revenue shortfall, partially offset by favorable head count-related costs resulting from the sales in technology transformations.

As Alex mentioned, we continue our strong audience growth with unique visits growing 13% and traffic growing 16% year-over-year. Direct monthly ARPD was $2,163 in the second quarter of 2019. Direct monthly ARPD excluding revenue from dealer websites and related digital solutions from Dealer Inspire was $2,052, down 2% year-over-year, primarily due to cancellations of certain product upsells and customer mix.

Dealer customers were 18,891 at June 30, 2019, down 2% compared to March 31, 2019. Direct dealer customers decreased by 307, primarily resulting from softness in April. As Alex mentioned, we saw improvements in May and June with growth in our direct marketplace dealer customers driven by a substantial improvement in cancellations rates.

Net cash provided by operating activities for the six-month period ending June 30, 2019 was $50.8 million compared to $70.6 million in the prior year. Free cash flow for the six-month period ending June 30, 2019, was

$41.4 million, compared to $64.2 million in the same period last year. Cash flow was impacted in both periods by payments associated with the early conversion of affiliate markets. Cash and cash equivalents was $9.5 million and debt outstanding was $680 million as of June 30, 2019.

During the six-month period, the company paid down $16.3 million of indebtedness and bought back $40 million of stock. Net leverage at June 30, 2019 was 3.25 times calculated in accordance with the company's credit agreement. We are expecting 2019 full-year revenue to decline between 6% and 9% with adjusted EBITDA margin between 27% and 29%.

This outlook includes the conversion of all remaining affiliate markets, which negatively impacts adjusted EBITDA margin by over 1%. The more pronounced decline in revenue for the year is driven mainly by steeper declines in national advertising revenue and slower growth in solutions revenue, mainly due to delayed OEM certifications and higher cancellation rates on legacy products. We anticipate returning to revenue growth and double-digit adjusted EBITDA growth in 2020.

At this time, 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, Becky. Look, adjusting our 2019 outlook is disappointing. The progress is evident throughout the business even though it is not yet translated into the revenue growth that we expected this year. We believe that despite taking more time than initially anticipated, we will succeed in converting increased customer value to increased revenue and profitability.

To give you a little bit more color, while we've driven significant growth in our solutions business, delays in OEM endorsements have put us behind our plans. We had expected more to contribute to 2019 revenue, but timing has shifted with certain OEMs. While many dealers are enthusiastically adopting our new solutions, downgrades have hampered our ARPD growth. And finally, our countermeasures to address the anticipated declines in National advertising this year are taking longer to yield results.

As you know, this is the worst new car sales market in the decade, but we are confident that we have right strategy and solutions and are taking the right steps to return to growth and double-digit adjusted EBITDA increases in 2020.

Since our spinoff two years ago, our team has been transforming our business, growing market share and continuing to lead the industry forward. We have made a tremendous amount of progress and I'm confident that our strategy will drive long-term profitable growth. In particular, we've achieved sustained traffic growth, continued improvement in product quality and lead delivery, double-digit growth in our solutions sales and notably significant improvements in dealer retention.

In addition, we now have converted all of our affiliates and we have achieved more than $30 million in annualized cost efficiencies across the business. Our strategy to unite media, digital solutions and data to drive more sales and operating efficiencies for the industry is concentrated around four key pillars: first, continue to optimize the benefits from our significant traffic brand and marketing expertise; second, drive product innovation and digital solutions to convert high-quality traffic to automobile sales for our customers and build upon the momentum we experienced with dealer customers in May and June; third, leverage our industry-leading sales force to assist our customers with relevant digital solutions and technology capabilities to deliver product innovation and growth in

ARPD; and, finally, reach the full revenue and cash flow benefits and direct access to more dealers through the early conversions beginning in the fourth quarter of 2019 with a significant profit upside coming in 2020.

Our plan is yielding results slower than we would like, but the trend lines are all improving. Multiple key operating metrics, particularly in dealer customer retention this quarter, demonstrate that our strategy is working and we are building momentum. We are confident that we have the right strategy and the right tools to address all these issues, returning to growth, and double-digit adjusted EBITDA increases in 2020.

With that, I'd now like to open up the line to your questions. Operator?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Tom White from D.A. Davidson. Your line is open. Please go ahead.

Tom White
Analyst, D.A. Davidson Companies

Q

Good morning. Thanks, guys. So just a question on the revenue outlook and the cut there. It doesn't all seem to be in the National advertising line. So I was just hoping you could give a bit more color about what's changed in the rest of the business and maybe elaborate on the OEM certification stuff and sounds like higher cancellation rates for some other products. Just trying to reconcile those things with the impact of the accelerated conversions, which should seemingly benefit revenues this year?

And then, just secondly, can you – on the share repurchases, can you just update us on where we stand with the buyback and thoughts on increasing that? Thanks.

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

A

Sure, Tom. Thank you. Well, listen. We're disappointed in the short-term impact to earnings, but we're reassured that the strategy is working and in the long-term view of the business. I think the predictability of the OEM spending is a degree of volatility for all North American players and who we talk to constantly and are seeing the volatility in the new car display advertising market.

And so that business has been much harder for us to predict. It has a pull-through impact on profitability more so than other revenue streams in the business, and that's why you see the impact on both top and bottom line. I think the solutions business is growing demonstrably, 31% growth in the quarter. It's well positioned for even more growth, but we had expected OEM endorsements earlier in this year and that's being tempered and now looking more towards 2020. And so the solutions growth is delayed in terms of its 2019 impact.

I think – and on the dealership side, revenues are behind largely due to a slower start in April, but we've stabilized the number one issue we've been dealing with this year, which is cancellations. And in May and June or back-to-back, our best months in over two years, and that's the real reward for our traffic growth, our solutions like AutoCorrected and Social Sales Drive. Dealers are recognizing our value delivery improvements.

And so we've stabilized really, I think, our number one challenge entering this year, but sales are slower than expected. We were expecting more growth in dealer spending through the second quarter and that growth hasn't appeared in the timing that we would have liked. To offset that obviously, we've done the cost cuts and identified a lot of savings in the business.

And as it relates to the affiliate issue you're asking about, most of that pull-forward is going to be happening in the third and fourth quarter. And so it won't have as big of an impact on revenue this year. You'll see the conversions are staggered throughout Q3 and Q4. And so you really won't feel the full-year revenue uplift and then $50 million in cash flow uplift in 2020.

I think on the share repurchases, on the other side, Becky, I'll let you comment on.

Becky A. Sheehan
Chief Financial Officer, Cars.com, Inc.
A

So you saw we've repurchased 20 million of shares during the second quarter and we have just over $60 million remaining on the existing share authorization.

Tom White
Analyst, D.A. Davidson Companies
Q

Okay. Thanks. Maybe I'll just slip in one quick follow-up and then jump back in the queue. Just, Alex, on the dealer trends, I think, last quarter and maybe even the quarter before that, you guys had signaled that you thought third quarter was when you guys could start growing sort of overall dealer count again, is that still achievable?

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

Well, look, I think quarter-to-date, the improvement on cancellations has persisted. We're seeing success in both July and August. So I think the fact that we've got that stabilization in the dealer base, I think, is huge. But we're only one month in and so sales is pacing lower than we expected. I think again the OEM delays is holding back some of the ARPD growth we have wanted. And then, the affiliate conversions, I think, obviously converting that business will shift our focus a bit in the second half of this year. And that's going to be new work that we're going to take on this year to bring that cash flow uplift into 2020.

Tom White
Analyst, D.A. Davidson Companies
Q

Okay. Thank you.

Operator: Our next question comes from Gary Prestopino from Barrington Research. Your line is open. Please go ahead.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.
Q

Good morning, everyone. Hey, Alex, is it possible that you could just throw some numbers around the trend and cancellations on the bar graph here?

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

Well, you could see, Gary, that the trend has been moving in the right direction. Cancellations were a huge challenge for us last year. They certainly persisted into – throughout the first quarter. And on a subscription business that can really dampen your full-year outlook. But that's why we've been so obsessed with getting traffic and value delivery increases because now dealers are recognizing that the market has shifted back in our favor in terms of traffic and value.

And so you're seeing that cancellation trend to be the most pronounced change in our business and including getting the growth in both May and June, which were really signs of life in terms of how we're shifting the business. I think the opportunity is to move that sales trend higher. That's obviously where we're focused now heading into the second half.

Gary Frank Prestopino Q
Analyst, Barrington Research Associates, Inc.

All right. So as I'm looking at this bar graph, I can assume that the net adds were more than the cancellations. That's kind of what I'm getting at.

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

Right. For Q2, you'll see April obviously had more...

Becky A. Sheehan A
Chief Financial Officer, Cars.com, Inc.

For May and June, Gary. Yeah. That's the line...

Gary Frank Prestopino Q
Analyst, Barrington Research Associates, Inc.

For May and June.

Becky A. Sheehan A
Chief Financial Officer, Cars.com, Inc.

...also, yep, that shows that net. The purple line has been net and the answer is yes.

Gary Frank Prestopino Q
Analyst, Barrington Research Associates, Inc.

Okay. And then, in terms of endorsements, you're talking about endorsements for the ancillary products that get held up with particularly websites. Is that kind of what you're leading to there with endorsements?

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

Correct. We had anticipated and we're told that we would be able to gain a certain OEM endorsement earlier this year to dealers that are held captive to exclusive agreements. And so we know that that dealers have continued to plead to us to help accelerate that change. We certainly need the OEM permission to be able to get these dealers to convert. We know certain competitors have exited or announced the intention to sale their part of the business that currently is held captive. And that certainly means that the trend is there. It's just happening slower than we would have liked to open up that dealer business.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. And then, in terms of you also mentioned the dealer advertising space, it's getting more competitive, right? You mentioned there were, I guess, Google taking share. In the scheme of things, how important is that to your overall business relative to what you're doing with the listings and all your ancillary services that you're offering?

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

A

Well, look, I think the platform players impact us not just on the dealer side, but more so on the OEM inside. I think as OEM profitability has been negatively impacted this year, we're seeing OEMs pull back and try to focus more on social platforms and ways to reach car buyers using data and bypass the endemic markets. I think, ironically, the dealer feedback has been frustrating because they want more OEM support to convert in-market shoppers into their stores. And so I do see a little bit of misalignment there that if we can get the manufacturers to more focus their marketing dollars on helping drive lead volume and traffic volume directly to the dealerships as opposed to brand campaigns, we're well-positioned to help perform that act.

And I think what you'll see from us in the second half is that we are starting to embed our dealer solutions strategy, that's showing a lot of life with the dealerships, with the OEMs. Becky commented that's going to take a little bit longer for OEMs to adopt, but the more we can embed conversion tools directly on to model pages on Cars.com that pull shoppers from new car research directly into sales opportunities, I think OEMs will realize we're actually more cost-effective than search and some of the other places where they're spending the majority of their budgets.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. Are you at liberty to answer any questions pertaining to the press release about the end of the strategic review?

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

A

Well, I think we try to be very thorough in providing as much visibility into the process, Gary. I will tell you it was a very extensive process, almost 30 parties involved, 10 months of time, and certainly no deals that were actionable. But we've detailed as much as we can say about that in the release to give all investors total transparency as to why we incurred both delays in our nomination window and the work that we were doing behind the scenes.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. Well, I want to get just back to that. When you say you didn't have anactionable bid or whatever. What does that exactly mean? Because as I'm reading under stage three, you did have bids from strategic X and strategic Y. I think the board said that strategic X offer was not acceptable and needed to be resolved. And I'm not splitting hairs here, but we have a stock that's down to $12 a share. On April 29, the stock was at $21. And I guess I would also say maybe your board chair should have been on this call to maybe explain some of this a little more thoroughly because that's kind of what we're getting from investors here.

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

A

Look, Gary, I appreciate your sentiment. I'll tell you we are limited in what we can say due to confidentiality obligations. I think if you look at the strategic X paragraph, the board looked at every available option and deemed that particular option have substantial risk to shareholders and wasn't viable we think in the interest of all shareholders. It really wasn't a sale. It would have resulted in shareholders owning the majority of the combined company, which we deem to have significant risk.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. All right. That's fine. Thank you.

Operator: Our next question comes from Steve Dyer from Craig-Hallum. Your line is open. Please go ahead.

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Thanks. Good morning. Most of mine have been answered. Just I guess a quick question just to clarify, Alex, it sounds like based on what you're seeing quarter three to date, you would expect net adds in Q3. So like churn has continued to lessen and I mean is that – did I hear that correctly?

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

A

I think part of our revised guide is to address some of the slowness we're seeing in sales growth. But, most importantly, we are seeing sustained improvement in the cancellation trend, which is very evident in July and was evident, obviously, in Q2. And so we're only a month in the quarter here, and sales are pacing a little bit lower than expected, but the cancellation rate absolutely is sustaining and showing increased improvement.

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

And just in terms of the sales, ultimately, what's the biggest pushback? You guys – traffic's been going in the right direction for a year and a half. You talk a lot about SEO and all of those types of things. When you're going to sell a dealer, what's the pushback that you're getting at this point? Is it price? Is it competition? What's left that you need to prove to them?

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

A

Well, I think, obviously, from a dealer sentiment standpoint, I think many of them still are dealing with challenges and profitability. New car sales being down. Even though used vehicle sales are up, used vehicle gross profit per sale is trending down. So most of our conversations with dealers today have been them being hampered by 2019's profit outlook. Although sentiment, I will note, is changing there and improving throughout the past month.

But that historically through Q2 had been much of the conversation as to why they weren't taking on incremental investments, or investing in solutions to the degree that we had expected. They were mostly seeking cost reductions in their operations. I think we are seeing clear recognition that the steps we're taking are working. The conversations, obviously, in the first quarter were more demands for cancel, and now we're entering into a period where the satisfaction with what we're delivering is definitely improving and visible to dealerships beyond just traffic numbers. Leads to dealers are up almost double-digits, while our quality scores are also improving very rapidly. And I think, we're getting that feedback played back to us loud and clear in the reduction and cancellations.

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. And then, in terms of the delayed OEM certifications, is that one OEM, is that multiple OEMs?

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

A

It's predominately one, although we have technically three, where they're re going through the approval process, we've gotten strong verbal indications from all that that not only are we a preferred provider, but we're the provider of choice. I think the approval process has been disappointing in terms of the speed at which it's taking. One makes up the majority of that opportunity. We were expecting it to appear more in 2019, but technically, there are two others that are also holding back revenue recognition at this time.

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

And with the large one, has that been resolved with the CDK issue you alluded to earlier?

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

A

It hasn't yet, which is part of our re-guide pointing towards 2020.

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. Okay. And then, just last one for me, as it relates to the buyback. Can you remind me if that's a 10b5-1 hence you're buying stock back according to a plan or, I guess, I'm just trying to get more of where the stock is now, and the results, and the guidance, and all those kinds of things, just curious as to how that would have been a good choice, if you had a choice, earlier in the quarter?

Becky A. Sheehan
Chief Financial Officer, Cars.com, Inc.

A

Yeah. So we've done both. We've done open market purchases and we were operating under a 10b5-1 plan for the purchases we've made so far. And as I mentioned on the earlier Q&A, we have about just over $60 million remaining in this share repurchase authorization.

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. Okay. Thank you.

Operator: Our next question comes from Nick Jones from Citi. Your line is open. Please go ahead.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks for taking my question, just one. Are you able to provide any update to the previously provided 2020 and 2021 guidance?

Becky A. Sheehan
Chief Financial Officer, Cars.com, Inc.

A

So what we've said on today's call is that if we look ahead, double-digit adjusted EBITDA growth in 2020 and that will be driven by a couple of things. So first, the completion of the affiliate conversions, which, of course, we highlighted on the call and we've got some slides in our material, both the completion and the end of the contracts and the contractual payments will benefit us from a profitability and cash flow perspective.

Secondly, of course, because of the cost reductions and the transformation work that we're undertaking this year, there will be improved cost efficiencies as we look ahead, which will be contributing to our profitability next year as well. That certainly would include the Sales Transformation and the technology transformation that's underway today.

And then lastly, of course, looking at the underlying metrics in the business with traffic, leads both growing and being able to deliver that incremental value to our customers as Alex highlighted with a stabilization of our dealer counts certainly coming out of the Q2 period.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thank you.

Operator: Our next question comes from Lee Krowl from B. Riley FBR. Your line is open. Please go ahead.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Great. Thank you for taking my questions. First one, just on the sales initiatives. You guys have talked about improving cancellation rates. But I wanted to just maybe come at it from a different angle and talk about your efforts on churn dealers and reactivation. You've had several quarters of multi-hundred dealer churn. But what are the efforts that are in place to bring some of these churn dealers back to the platform?

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

A

Well, I think we're seeing those actions happen right now because many of the dealers that previously had dropped cars are also being hit with rate increases from competitors and which is putting to light our value as being an efficient platform for their vehicle sales more in view.

And so many of the dealerships that had previously cancelled cars were actively in discussions with and we have a scheduled, follow-through process. Once dealers come down, we obviously give them some time once they've made that decision. But the reengagement plan is time-driven, and we're starting to see some return in terms of dealers that had cancelled back to the platform.

And that certainly is reassuring. And I think obviously it's hard to look at this on a national level. But when you isolate the traffic trends and the lead delivery trends on a per dealer basis, our value delivery is up double-digits with most our dealers – while our competition's value delivery is being cut by a similar amount. And I think that's making dealerships reconsider who they're picking as their primary partner. And I hope to see that trend continue in the second half.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. And then, on National, you added a new director for the National business. Is it safe to say that National continues to decline this year, but is there any opportunity for that business to eventually grow, or is it kind of more of a secular headwind that we just have to grow into accept?

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

A

Look, I think the National business certainly is the challenge we're now focused on turning around. I would tell you that, number one, the fact that we have people actively shopping for the very cars the manufacturers are trying to sell gives me a huge degree of confidence that we're where they need to be. I think the impact we felt this year has certainly been more sudden and unexpected. And I think the profit warnings and the challenges the OEMs are facing certainly is real.

We know that the strategy we've been executing with dealers, we think, is analogous to what we can do with OEMs. And we're currently in conversations with many of the OEMs who actually want to do more with us. While we have six OEMs that have pulled back, we also have other smaller OEMs who've pulled forward and are stepping up because they see more clearly that we're impacting their vehicle sales. And so what we need to do is embed our solutions strategy with the OEMs as well.

The solution strategy is analogous to giving our customers more visibility in terms of the impact we're having on their business. And I think the more we can show the OEMs' PII conversion data and how that flows through to their dealer websites and provide visibility even to sales attribution, the more I think the investments will accelerate. But we know that 2019 is particularly difficult for OEMs right now and so we think that turnaround is going to take time.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. And then the last one for me, the Dealer Inspire business grew about 31% in the quarter, and then, obviously, you have this OEM headwind just from certification. Would you expect the Dealer Inspire business to grow at a similar rate as Q2 in the second half or does it decelerate in the second half and then reaccelerate as these OEMs become certified in 2020?

Becky A. Sheehan
Chief Financial Officer, Cars.com, Inc.

A

We think there's some deceleration in the second half, and then the reacceleration, as you just described, in 2020.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. Thank you for taking my questions.

Operator: Our next question comes from Marvin Fong from BTIG. Your line is open. Please go ahead.

Marvin Fong
Analyst, BTIG LLC

Q

Hey. Thank you for taking my questions. I guess the first one, just to drill down further on ARPD, I think, Becky had talked about cancellations, more difficulty on upsells and from mix. So first question is just could you elaborate on that? What exactly changed from Q2 from Q1 because it seemed like I think Q1 was up a little bit on an organic basis? Is it really just this focus on gross profit at the dealer level?

And then, just the second part of that question is, how should we think about that number trending for the rest of the year? Should we think of it stabilizing at this $2,050 level? Or should we expect further pressure? Thanks.

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

A

Thank you, Marvin. Well, first of all, yes, we did have mix shifting in Q2, where we did take on significantly more dealers of a smaller scale so not the same spend levels that some of the larger dealers and franchise markets. And so part of the mix shift was also impacted though by slower sales on the upside and some downgrades of our legacy solutions. So all three of those factors muted ARPD growth, which we had expected through the second quarter and going into Q3. I think from a go-forward standpoint, keep in mind that we're going to be converting the affiliate dealers in all the Gannett markets in the second half.

And because those dealers tend to be in smaller cities throughout the country, I think that has tempered our ARPD outlook because our pricing model is first and foremost based on market size. The largest DMAs cost more to be with Cars.com than the smallest DMA. So we'll see continued mix shift in terms of the dealer ARPD in our model, but we definitely see it more stable, not something that we would expect to materially decline.

Marvin Fong
Analyst, BTIG LLC

Q

Great. And just spin a little bit on the advertising line, should we expect similar pressurizing the second quarter or the fact that you're sort of anniversarying some larger declines a year ago? Should we think we can improve on the down 29% that we saw this quarter? Thanks.

Becky A. Sheehan
Chief Financial Officer, Cars.com, Inc.

A

Look, the predictability of our national advertising business will continue to stay is the hardest to get. The OEMs are volatile with respect to their spending decisions and that's been evidenced when you look at the revenue trend lines in our business. Sitting where we are right now, we are not expecting an acceleration or an improvement for National for the remainder of this year.

Marvin Fong
Analyst, BTIG LLC

Q

Okay. All right. Thanks a lot.

Operator: Our next question from Dan Kurnos from Benchmark Company. Your line is open. Please, go ahead.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Great. Thanks. Good morning. Alex, can you just talk to why you're seeing accelerated affiliate dealer churn and what with the conversions you have in the back half of the year you're assuming is going to happen? And just maybe if you could, if you're willing to break it out, just how do we think about the dealers that you converted in the last batch of the affiliates, how are those performing relative to legacy from a retention in ARPD standpoint?

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

A

Great. Thanks, Dan. Well, look, going into this year, we didn't have much growth plan for affiliate as they were entering in the final year of the remaining contract term. And, however, what we saw happening throughout the first half was affiliates pulling back on their sales resources and seeing the dealer slide accelerate. We realized we couldn't afford them just to tank the business so we engaged and negotiated early conversions with all the remaining parties.

Number one is a way to mitigate continued dealer losses because the dealers weren't being sold our full value and we wanted to get in there and stabilize that dealer base. In all the prior conversions, we had experienced a similar trend where the rate of decline had been accelerating and we were able to come in and largely stabilize the dealer losses. I think the retail visibility has always been an issue. We don't know how these contracts are packaged or sold when we come into the markets. And so we're largely trying to bring the dealers in from an ARPD standpoint at their existing levels.

But we're seeing that the former affiliates that we've done have all restored to more mirror, the same trends that we're seeing across the rest of our direct business, which is a higher uptake in solution sales most predominantly. And so we'd expect that to be the case in these remaining markets as well. I certainly know that any time you switch the sales relationship with dealers, it's a point of negotiation. But we certainly know that the increase in traffic and value delivery is being talked about across the industry, and dealers are noticing that we're investing more for their growth.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

So just to be clear, contemplated maybe in the new guidance, if you convert in Q4 possible uptick in dealer churn from conversion, but then all of this kind of flows through into 2020, is that the right way to look at it?

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

A

I think that's the right way to look at it, Dan.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Okay. And then, Alex, obviously, the other portion of that or piece of that has just been on the billings side. Now that you've negotiated, have you been able to yet get in and see their books yet especially Gannett's or is that still outstanding until you take over on October 1?

Becky A. Sheehan
Chief Financial Officer, Cars.com, Inc.

A

It's all in process at this time, actually.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Okay.

Becky A. Sheehan
Chief Financial Officer, Cars.com, Inc.

A

We're working through it now, Dan.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

And then, not to be too cute with this, I just want to make sure I understand it. The growth year-over-year was good in traffic. In visits, it was down slightly sequentially though. I don't know if that was seasonality. Is this kind of the new run rate or do you have plans with conversion and whatever to reaccelerate and keep moving upwards and at what pace should we expect over time?

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

A

Dan, for every in-market site and even all automotive sites, traffic trends are always higher in the first half of the year because that's where the bulk of car shopping is, and then seasonally shift down throughout the year. What we would point to though is our double-digit gains in SEO are bucking that trend, up 49% in Q1, up 51% in Q2. And so we're seeing not a temporary acceleration of SEO, but an acceleration that's been sustained now for quite some time.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Yeah. I guess, I just asked it, Alex, because your Q3 was in line with the Q1 last year. And given that where you'd come from, it seemed like you had an opportunity to go after, go after more growth there. But, I guess, just one other piece of that then, just on some of the solutions, Alex, I don't know if you had a chance to talk about it, some of the ancillary products you've launched, is the last question for me, how that's contributing to traffic growth and lead conversion, which you did talk about, obviously, the match program, which I didn't think you mention this quarter, and some of the geo-fencing and geo-targeting stuff you've been working on, if you could just talk to that and how that's contributing would be helpful. Thanks.

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

A

Sure. One comment on the traffic side, I will say that the traffic was up, I think, we were down 11% in Q1 of 2018, only up 4% in Q2 in 2018. And so that's on the SEO side. On UVs overall, in Q1, only up high-single-digits, 8%, 9%, and now we're trending at 16% and 13% in Q1 and Q2. So the traffic trends across UVs, visits, and SEO are all queuing and moving in the right direction.

I think on the solutions side, certainly, the biggest hits this year had been AutoCorrected and Social Sales Drive because they're adding demonstrative value to dealerships as a way to mitigate dealers questioning our value. I think Cars Social, which is our Facebook retargeting solution, has been an absolute hit and continues to scale.

I think what's frustrating is that the losses of some of our legacy display upsells with dealers is muting some of that success. And so dealers will say, look, I want to buy your social product, but in order to fund it, I'm going to drop $500 off this display upsells but keep on listings package. So my ARPD may go up a little bit, but it's somewhat offset by softness in the display legacy solutions.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Got it. Thanks for all the color, Alex.

Operator: Our last question comes from Doug Arthur from Huber Research. Your line is open. Please go ahead.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Yeah. Thanks. I'm covered. Thank you very much.

Operator: There are no further questions at this time. I'll turn the call back over to Alex Vetter.

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

We want to thank you for your time today and we look forward to talking to you again soon.

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