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Cars.com, Inc. (CARS)

Q1 2019 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and welcome to the Cars.com First Quarter 2019 Earnings Conference Call. Hosting this call this morning is Alex Vetter, Chief Executive Officer; and Becky Sheehan, 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 May 24. 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 first 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 first 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 first quarter of 2019. On this morning's call, we'll be discussing our first quarter business performance and then hand the call over to Becky who will discuss our financial results. You will recall last year we expanded from a listings-only model to a digital solutions platform. Our differentiated proposition offers dealers a greater array of sales tools and a better user experience for car buyers. We believe that our strategy will propel us to sustainable market leadership over time. We also believe that we are best positioned among all our competitors to successfully execute this strategy.

In the first quarter, we increased our product and performance marketing investments and drove a record number of leads focused on quality to translate into more sales for our dealer customers. [ph] We are (00:02:30) the leading brand and highest organic traffic in our category. And we've also developed proven capabilities of performance marketing and achieved remarkable last year results. With a consistent delivery of more high-quality leads through increasing exposure to an end-market car buying audience and integrated digital product solutions, we continue to affect dealer growth beginning in the third quarter.

Let me explain how this will happen. During the fourth quarter 2018 conference call, we introduced a plan with three primary initiatives that will grow dealer subscriptions. First, a program of incremental marketing investment is driving quality traffic and leads that convert to vehicle sales for our customers. Our winning streak and growing traffic continued through the first quarter of 2019. Driving this growth is significant competitive share shift in SEO traffic, as we're now taking meaningful market share. I'll talk more about this in a moment.

Second, a relentless focus on product innovation to deliver greater audience growth and engagement. Our product innovation not only improves user experience, but also sales conversion and helps dealers maximize their profit. In the first quarter, we launched AutoCorrected. It's a tremendous timesaver for dealers and allows dealers to maximize their exposure and profits by ensuring that vehicle listings are properly merchandised. AutoCorrected is the latest in a series of product launches that benefit from the seamless integration of Cars.com and Dealer Inspire. The positive momentum in our B2B solutions continued in the first quarter. Our website customers grew to nearly 2,700 and revenue increased 24%.

And finally, the new sales structure which we implemented in December focuses on providing dealer customers with ready access to product specialists and data-driven account management systems designed to improve retention and product sales. Our traffic strategy and our organic strength is differentiated and sustainable. We are taking share with traffic up 17% year-over-year in the first quarter.

Audience and traffic are fundamental to the strength of our marketplace proposition, and the team continues to deliver an impressive user growth. The Cars.com brand name is stronger than ever, achieving 73% awareness in March, an all-time high. I'm incredibly proud of the work our team has done to widen the gap between Cars.com and the competition. And this strength translates into organic growth and value delivery. And with the average car shopper being in market only once every seven years, brand recognition and organic traffic strength is critical to generate meaningful sustainable returns.

Our Salesperson Connect [ph] brand created (00:05:21) launched in early March, which included integration with the NCAA March Madness tournament. We are currently a sponsor of the Stanley Cup Playoffs and will be featured next week in the PGA Championship. These investments will ensure a sustained exposure throughout Q2 and into the critical summer months. But perhaps [ph] our proudest (00:05:42) achievement comes as a result of years of hard work, building stronger systems and process around improving our organic traffic strategy.

Our continuous innovation and steadfast commitment to a sustained focus on quality and fair play within Google Search algorithms began paying off last year and continues. We achieved 49% year-over-year growth in SEO traffic in the first quarter, driving record traffic and leads. And importantly, the shift in our SEO strategy from research to listings is producing record leads with the highest quality for our dealer partners. We stayed true to our focus on usability, original content and improving speed, all while strictly adhering to Google's guidelines. This high-quality approach is being rewarded.

When a dealer cancels, the reason most often cited are lead volume and lead quality [ph] or proceeds (00:06:40) lower sales conversion. With our success in traffic growth and product innovation, we have driven record lead volume and improved quality. In the first quarter, our total leads grew 15%. Keep in mind, the most material shift in SEO market share took place just at the end of the first quarter. It continues to accelerate into Q2. This free traffic is pacing as higher than our plan for value delivery, while [ph] also scoring well with (00:07:08) dealers who want to tap into this momentum and shift in volume and value. This may even allow us to spend less in marketing as we built an organically strong, sustainable traffic delivery system.

Lead quality is a function of relevant traffic in digital products that enable dealers to convert traffic into incremental sales. And product innovation is also at the heart of our strategy and differentiates our business.

For example, in Q1, we made industry news with the launch of AutoCorrected, a first-ever automated way to improve the visibility and quality of dealers' listings with more complete information. Kris Cox from Cox Chevrolet said it best and I quote, "the task of verifying trend levels, equipment and features across third-party sites has been frustrating. Thank you, Cars.com, for providing AutoCorrected for our inventory. We no longer have to worry about vehicles being represented accurately. And we've seen a 20% increase in connections since using AutoCorrected."

Our focus on product quality and helping our dealer partners is validated through third-party data. Driven data analyze aggregated data from over 130 dealer management systems. And in the first quarter, Cars.com was number one in average gross profit per used car at nearly $1,800, while competitors focus on cheap cars [ph] or SEM (00:08:34) to drive up search cost on aging inventory. Cars.com helps shoppers find the best cars and helps the dealers merchandise them fully to maximize profit. And these are only part of the story.

Now, we are leveraging our technology solutions to further improve dealer performance and ROI. Roxanne is a new pixel-based approach to track consumer shopping behavior between Cars.com and dealer websites to [ph] eliminate cross (00:09:00) shopping. From this data, we see that consumers who are cross shopping between Cars.com and a dealers' website are more engaged than consumers who come from other sources. Cross shoppers from Cars.com are looking at five times the number of vehicle detail pages and are 37% more likely to return for a second visit. And Cars.com users are four times more likely to buy a vehicle from that dealer.

As dealers are constantly seeking sources of high-quality traffic to their own website, Roxanne will provide more evidence that there is no better partner than Cars.com driving organic traffic value in sales directly to our dealers. It is this type of analytics and solutions that are differentiated and drive a clearer articulation of our value.

During our call last quarter, we talked about our long-term strategic plans to deliver sustainable market leadership, revenue growth and double-digit EDITDA growth. Near term, as we look through the remainder of the year, we're focused on these objectives we set for ourselves at the beginning of 2019 to grow revenue.

First, leverage our best-in-class brand and marketing expertise to provide more value to our customers in order to add more rooftops and reduce customer churn. Second, deliver innovative products and solutions that improve our clients' business; and, third, leverage our industry-leading sales and technology capabilities to continue to innovate and sell to our clients and, finally, to gain control of the remainder of our affiliate relationships and cost effectively pursue our digital solutions strategy.

We're doing this while maintaining the industry's leading margins and driving further operational efficiencies with favorable year-over-year expense levels in sales, product, technology and G&A. As we look ahead to our future, we are taking the necessary steps and exploring all the options that we believe are best for our business, our customers and our fellow shareholders.

As many of you are aware, we are in the midst of a process to review strategic alternatives for our business. This process is ongoing, and we remain engaged with multiple parties. Naturally, there's heightened interest and curiosity to learn more about our progress. However, we cannot comment beyond what we've shared in our press release. I'm very excited about our future as we leverage our best-in-class marketing expertise, develop best-in-class dealer solutions, drive industry-leading innovation and generate further growth in revenue and profitability by gaining full control of the remaining affiliate conversions.

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 first quarter of 2019 was $154.2 million compared to $160 million in the prior-year period. The decline was primarily driven by a decline in dealer count, softness in our national advertising business, offset in part by strength in our Dealer Inspire business.

Direct revenue was up $13.6 million, driven by the early conversion of the tronc, McClatchy and Washington Post markets throughout 2018, resulting in $13.2 million of incremental direct revenue in the first quarter. These conversions also resulted in an $11.4 million decline in wholesale revenue during the quarter. Dealer Inspire contributed to the growth in direct revenue due to continuing rapid growth across all of our core product lines and its results being included in the quarter for the full period. Excluding the affiliate market conversions and the Dealer Inspire business, our direct revenue declined $11.1 million or 14%, driven by softness in dealer counts.

Our National advertising business, principally sales to OEMs, was down 24% in the first quarter compared to the prior-year period. This was driven by lower 2019 upfront commitments and fewer scatter market sales in the first quarter. While traffic growth increases our advertising opportunity, we are also taking a number of steps to improve our current product offerings and introduce new solutions. We expect to hire a new leader for this business in the coming months, which will further help us accelerate our shift into more data-driven performance marketing solutions. Shifting to these new products will take time. We continue to be cautious about this channel and continue to project a decline in our National business in 2019.

Excluding affiliate conversions, wholesale revenue of $14.9 million was down $1.4 million compared to the prior-year period. This was primarily driven by a 9% decline in affiliate dealer customers. Total operating expenses for the first quarter of 2019 were $158.3 million compared to $152.8 million for the prior-year period. This increase is driven by the addition of $10.2 million of cost related to Dealer Inspire and $4.2 million of increased depreciation and amortization, partially offset by a $3.1 million decrease in non-recurring costs. We realized operating efficiencies across product, technology, sales and marketing during the quarter.

Net loss for the first quarter of 2019 was $9 million or $0.13 per diluted share compared to net income of $0.9 million or $0.01 per diluted share in the first quarter of 2018. Adjusted net income for the first quarter of 2019 was $20.7 million or $0.31 per diluted share compared to $28.5 million or $0.39 per diluted share in the first quarter of 2018. Adjusted EBITDA for the first quarter of 2019 was $38.6 million or 25% of revenue compared to $47 million or 29% of revenue for the prior-year period.

As Alex mentioned, our audience growth continued its strong trajectory in the first quarter with unique visitors growing 16% and traffic growing 17% year-over-year. Direct ARPD, excluding revenue from dealer websites and the related digital solutions from Dealer Inspire, grew 3% year-over-year, driven by the favorable impact of the increase in large dealers in larger markets that we now control. This is the first quarter we are including revenue from websites and related digital solutions in ARPD, consistent with our strategy to sell digital solutions to our customers. Including this revenue from Dealer Inspire products, our direct monthly ARPD in the first quarter was $2,225. Dealer customers were 19,300 at March 31, 2019, down 3% compared to December 31, 2018 due to higher cancellations of marketplace customers, offset in part by growth in Dealer Inspire-only customers.

As we said in our February call, we anticipated a decrease in dealer count, following the changes to our sales structure. In March, our cancellation rate was at a four – five-month low, and our largest franchised dealer customers had the most significant reduction in cancellation volume compared to the December through February timeframe.

Net cash provided by operating activities for the three-month period ending December – or, excuse me, March 31, 2019 was $38.4 million with free cash flow of $35 million, representing growth of $11.7 million and $10.9 million, respectively. This increase was primarily due to changes in working capital. Cash flow was impacted in both periods by payments associated with the early conversion of affiliate markets. With our free cash flow in the first quarter, we repurchased 0.9 million shares for a total of $20 million and repaid $10.6 million of our outstanding debt.

Cash and cash equivalents was $28.3 million and debt outstanding was $685.6 million at March 31, 2019. During the three-month period, the company paid down $10.6 million of indebtedness. Net leverage at March 31, 2019 was 3 times, calculated in accordance with our credit agreement.

I'll now take a moment to provide a brief update on our project to modernize our technology platform that we discussed last quarter. As a reminder, we are moving to a cloud-first infrastructure, which will allow us to be more efficient, improve our speed of product delivery and reduce our datacenter footprint. Our work is well underway, and we are on track to complete in 2020. Following the completion, we expect to realize $10 million in annualized cost efficiencies. Keep in mind, in 2019, we will incur the cost of running parallel systems as we migrate to the cloud. As for outlook, we continue to expect 2019 revenue between a 5% decline and 2% growth with adjusted EBITDA margins between 30% and 31%, as we discussed on our last earnings call.

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. I'm incredibly proud of the progress we've made with our product innovation and our traffic strategy, especially our record SEO share gains which together are driving higher conversion and better quality leads, which will directly help us improve dealer subscriptions over time. We are also intently focused on taking the necessary steps to maximize long-term profitability. With the sales and technology reorganizations now behind us, we are transforming into the market-leading digital solutions provider. I know we have the team, the strategy and the commitments to propel us into sustainable market leadership.

Before we open up the call for questions, I want to take a brief moment to mention a program that we're also really proud of. In honor of Memorial Day, in recognition of military families everywhere, Cars is launching new partnerships with TAPS, Tragedy Assistance Program for Survivors, an organization that does crucial work to support families grieving a military loss. Since 1994, TAPS has helped more than 85,000 families, casualty officers and caregivers, providing cost-free comfort and hope through peer support and grief resources. We are humbled by the service and sacrifice of these families and the work of this important organization.

Cars is committing up to $1 million in media support to help raise awareness of TAPS and the much needed work it does for the survivors of our fallen servicemen and women. And we're also working with our customers nationwide to generate more awareness and support for TAPS locally. To learn more about this, please visit cars.com/taps.

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

QUESTION AND ANSWER SECTION

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

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

Great. Thanks for taking my question. Good morning, guys. Two, if I may. So, very solid outcome on the traffic trends. And I guess my first question is just kind of how that relates to what's happening on the dealer count side. So, you saw some elevated churn in January and February that's since improved. But would just be curious to hear more color on kind of what drove that churn. Presumably, dealers, I imagine, have started to notice that the traffic and connection volume has – it has been growing again and has for the last few quarters. So, just curious why you saw that churn.

And then, just on the National ads business, can you maybe provide just some more specifics about how you can make that more of a growth driver or, at least, less of a risk to seems like it's kind of lumpy because you've got a handful of large OEMs who can shift spend around? So, just some more specifics there and maybe where National ads ranks on your list of priorities at the moment. Thanks.

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

Sure. Thanks, Tom. Look, we did have elevated churn in the first quarter. That was more a result of our sales transformation. We know that this is a performance industry, but it also is heavily relationship-oriented and [ph] when we (00:22:43) impacted a fairly significant size of our sales force, we had increased cancellations in the first quarter as a result of that shift in strategy. However, as you know, Tom, we've shifted our sales approach to gear more support for multi-store dealer groups and more data-driven account management and we're starting to see the green shoots of that like we saw in March in some of the positive improvements.

We also introduced our Social Sales Drive and AutoCorrected offering, which – for the dealers that we've opted in to those services, our cancellation rates are below 1%. So, big priority for us in the second quarter and through the summer months is going to be getting more and more dealers on these value-added programs, so they can see better conversion and improved performance in their listings and results.

When we look at the dealer CRM data, it's very clear to us that we can show dealers growing trends in terms of the number of leads, phone calls and sales conversions that we're generating this quarter over the last. And dealers are very aware of that improving trend.

On the National side, I think – obviously, as we guided this business to be down for the full year, I will tell you the concentration of revenue with big clients is both a challenge, but it also is part of the reason we're optimistic on a full year basis to maintain our guide because many of the OEMs that had pulled back earlier in the year are increasing conversations with us, partially in turn because of the growing traffic strength that we're demonstrating.

And so, there still is potential that these OEMs can come back in the second half of the year, particularly now that the demise of the SAAR has been ruled out. It's a very healthy year. And manufacturers are realizing they've got to get back and start helping drive conversion for their dealer customers. It certainly remains a priority. We're actively recruiting a leader for the business. But I'm impressed with the team in terms of how they've brought new solutions to market. And there is a lot of optimism still in the business.

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

Q

Great. Thanks for the color.

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

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Hi. Good morning, everyone. Could you just give me what the vehicle listings were in the quarter?

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

A

Sure, Gary. I know used vehicle listings were up 2% in the quarter. New car listings are down about 13%. So, that's a 7% drop in vehicle count.

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

A

So, total was just over 4.5 million.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. 4.5 million? Okay. And then, looking at slide 10, when you're talking about dealer retention, lead quality and Autocorrect with this data, is this data for used car gross profit a function of what you've generated with dealers that have Autocorrect (sic) [AutoCorrected] (00:25:48)? Or is that all across the board?

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

A

Across the board, Gary. We've – part of our marketing investment strategy is to drive more high-quality leads directly to all dealers. I think that improvement is being amplified by the dealers that have enrolled for AutoCorrected because, now, their vehicles are appearing in more search results – more long-tail search results for consumers and the cars are being better merchandised. And so, first and foremost, I would say we're seeing this growth across the board because we're really shifting our media strategy into high-quality channels, driving direct high-quality leads into dealer CRM systems. Certainly, the organic growth in SEO traffic has driven the vast majority of that improvement, which is quite exciting.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Do you have the data for just what the AutoCorrected dealers did, I mean, because it would seem to me that one of the frustrations of searching for a car is not getting the correct trim?

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

A

That's right. I mean, many of our competitors scrape website listings or don't get complete feeds. We're very intentional about helping the dealers maximize their merchandising and marketing. We now have dealers asking us how they can get AutoCorrected onto their own websites, which obviously if they upgrade to Dealer Inspire, it's automatic and that will help us with dealer website sales throughout this year because it's another value-added service that comes from the Cars family.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. Well, [ph] we could eventually to see that (00:27:31) data if you could provide it because I think that's important. And then, lastly, when you're talking about leads, is that click-throughs directly from your website to the dealer? Or is that something you're pulling out of the CRM systems of the dealers or the DMS systems of the dealers?

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

A

So, I think you're asking about [ph] AutoCorrected or Roxanne? (00:27:53)

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

No [indiscernible] (00:27:56) you said leads were up 15%. So, I'm just saying [indiscernible] (00:28:00) what is that exactly? Is that a click-through from your website into the dealers' website? Or is there a whole bunch of things that are factored in there?

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

A

Thanks, Gary. Thanks for the clarification. That is just e-mail and phone leads, which represent the predominant measure of value that dealers look at in evaluating ROI. So, those are e-mails and phone calls, both with PII.

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

Okay. Thank you.

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

Daniel Powell
Analyst, Goldman Sachs & Co. LLC
Q

Thanks. Appreciate you taking the question. I wanted to ask a little bit more on the traffic side of things. I guess, one, did you see whether on mobile or desktop the impact of the algorithm change was more pronounced this quarter? And kind of off the back of that, during the past algorithm changes that have obviously happened in Google, what has tended to be the sort of longer-term implication of that? Is there a snapback? Or is there a steady improvement off of that base? I'm just trying to get a sense of sort of how sustainable you guys view the change in the algorithm and your ability to leverage that.

And then, the second question, just on the gross profit per unit that you quoted in Q1, how much of that is a function of you being able to drive better conversion versus any potential changes around mix shift to larger dealers that you might be seeing? Thanks.

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

Sure. Well, first of all, for Q1, almost 70% of our total traffic is coming to us through mobile devices. And so, mobile continues to be our strongest area of both opportunity and growth. And the SEO changes specifically have not been platform-specific. They have been across the board, both desktop and mobile environments, because the change in our estimation is more about high-quality content and consistent adherence to Google's guidelines and standards, which apply to both mobile and desktop experiences. And that certainly has driven a good mix shift in lead traffic. Historically, our SEO gains have been more in our research content and our editorial content. Most of the shift we're seeing now is accelerating in our search results, which is the primary revenue channel to generate value delivery for our dealers. And so, that's creating a lot of efficiency in our value delivery systems of high-quality traffic, very low funnel end-market car shoppers directly to our dealers.

Your second question was really more about the sustainability of the changes. And I would say we certainly know that Google will always tweak their algorithms. However, most of the industry insights will say this has been the largest change that they've done in years. And the change only went down on March 12. And so far into Q2, we're seeing those changes accelerate into the second quarter.

Daniel Powell
Analyst, Goldman Sachs & Co. LLC
Q

And then, just any commentary around the gross profit per unit that you're driving relative to competitors. It sounds like you guys are seeing some benefits on the conversion side of things. But I'm just wondering if there is any mix shift to larger dealers or anything like that that could also be playing into that number.

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

We don't see any material mix shift there. I know much of our success has been going to the larger franchise dealers who tend to be our biggest clients and spend the most. But increasingly the value is going to the dealers that are spending higher average revenue per dealer because they tend to participate with us beyond [ph] our base subscription (00:31:49). So, they're doing things like Social Sales Drive, Cars Social. And the dealers that have upgraded those into our preferred packages are generating even higher returns.

Daniel Powell
Analyst, Goldman Sachs & Co. LLC
Q

Great. Thanks so much.

Operator: Your next question comes from the line of Sameet Sinha with B. Riley. Your line is open.

Sameet Sinha
Analyst, B. Riley FBR, Inc.
Q

Yes. Thank you very much. And I apologize if these questions have been asked. I just joined a little late. But two questions. First is, Alex, can you give us a sense of [ph] what the churn trends (00:32:22) are in the second quarter very similar to the way you had kind of characterized it when you reported Q4.

And my second question is – it's a multi-part question, basically focusing on the new products. Definitely, it seems like that strategy is working. And when [ph] we speak with (00:32:42) dealers, we hear the same thing [ph] that the other product the (00:32:46) multi-product strategy [indiscernible] (00:32:47). But can you help us think about which of these new products do you think has the maximum potential according to you, how you prioritize that and also talk about in the context of the growth in social advertising, your social products and how you're leveraging and where do they stand in the roadmap and in your priorities? Thank you.

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

Sure. Well, the trends we're seeing in churn are similar to what we saw in Q1. Although I'll say that we're seeing an improved cancellation rate, March was our lowest cancellation rate in a five-month horizon. So, the March data was important. And we see continued improvements in those trends in the second quarter. Importantly, keep in mind that our sales transformation really happened in mid-December. So, I think that had the biggest headwind in terms of our [ph] gross sales (00:33:42) performance. Now that that's behind us, I think our sales team is more focused on growth and customer acquisition. And certainly, the traffic trends and the value increases and organic shift in share are all tailwinds that I think our teams are excited about.

On the new product side, Sameet, certainly, I would have to recognize Social as having the broadest organizational impact and that we haven't even really begun to penetrate that with OEMs. And our retargeting of Cars.com shoppers in social environments has been a huge success for dealers. But the real strength I would signal to is our Dealer Inspire business and the growth rate and trends we're seeing there with OEMs and dealers. We added three new endorsements in the first quarter for DI in Subaru, Lexus and Toyota. We've also added even players like Harley-Davidson who want to make sure their stores are optimized digitally.

And so, now, when you look at all the OEMs are pointing to us as being the premier provider in the industry, dealer adoption continues to go to move off the legacy website systems providers into our more innovative mobile-centric solutions.

Sameet Sinha
Analyst, B. Riley FBR, Inc.

Q

Right. And which of these – I mean, if you were [indiscernible] (00:35:04) rank them in order, which of these do you think have the largest opportunity, excluding DI? I'm talking about more sort of things that you have built in-house.

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

A

It depends on the customer segment. I certainly, again, would say Social probably has the broadest appeal between OEMs and dealers. But again, I think one of the big priorities we want to get into the market in this year would be AutoCorrected because it helps dealers merchandise and perform better. And then, Online Shopper, which is our digital retail tool, we're seeing phenomenal conversion rate improvements for dealers that upgrade into a tool that helps consumers calculate monthly payments and provide trade-in information. And so, the richness of the content that those leads are generating into the dealer systems makes our value very vivid and leaves no room for debate as to who drove the lead in the sale. And so, those would be a couple of the initiatives that I think will be transformative for us as we begin to roll those out in greater, greater scale.

Sameet Sinha
Analyst, B. Riley FBR, Inc.

Q

Great. Thank you.

Operator: Your next question comes from the line of Dan Kurnos with Benchmark Company. Your line is open.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Great. Thanks. Good morning. Alex, I'll just ask the – some of the previous questions a little bit more of a pointed way. Do you anticipate that 2Q will be a trough for dealer customers?

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

A

We actually have guided that dealer growth will turn in the third quarter.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Yeah. So, that's what I'm saying. So, you're still sticking with that? So, you'll return to sequential dealer growth in Q3?

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

A

Yeah. We – Dan, we said on the year-end call and on today's call both that dealer growth, we anticipate beginning in Q3. That's right.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Perfect. All right. So, look – so, the reason that – I mean, the other question is sort of dancing around that. Alex, look, the – obviously, the product side has been performing at a level above I think almost everyone's expectations. And so, what I want to dig into a little bit, I think you alluded to it in some of your prepared remarks and some of your responses in Q&A here, is with kind of the new sales force, you have an opportunity to reset the messaging to the dealers. And it feels like you've got a significantly altered go-to-market strategy. Clearly, it's helping you so your traffic trends are turning. So, that's just another arrow in the quiver right? But it seems like there has been a pretty good uptick on DI, which is probably helping support the underlying dealer numbers along with the ancillary product launches.

So, if you can just talk to kind of maybe that revised messaging – I could be entirely off base. But just sort of your thoughts on that and the sort of the go-to-market now that you've kind of reset at the end of the year and you're starting to come out on the other side here.

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

A

Well, I think – Dan, thank you for that. Certainly, we have transformed the sales force to be more performance oriented and provide dealers a more data-driven experience. I think the exhibits of that transformation do come through to the dealers when they hear about AutoCorrected when we rolled out our integrated Facebook Messenger product with Social Sales Drive. And certainly, when we are able to show them back-end analytics on their own website and how that traffic is converting from Cars.com which isn't just the leads but we're talking about the actual web trends and traffic. And so, our sales teams are learning these new languages and bringing that data and insight to the dealer, which I can tell you it's a different phone and conversation that they're getting from our competition which tends to talk about [ph] rate on leads and – on (00:39:05) declining per dealer KPIs.

So, I think our differentiated story that we're bringing more to the dealers than just traffic and leads and that we're bringing data-driven solutions that help them improve their gross profit make them more efficient and ultimately provide them a higher degree of service. I think it's starting to be seen and felt in the market. And I would say that it's mostly being recognized where we shifted our sales force, which is to the larger dealer groups and regional groups. Previously, as you know, dealer groups who had 12 or 20 stores sometimes had to work with multiple parties to work on their Cars.com account. We now have centralized dedicated account teams that are hyper-focused on the success of those dealer groups. And that's what's also translating to our growth in average revenue per dealer. If you look at our ARPD growth, growing at 3% on an isolated basis is impressive. But now, you're also seeing, when you blend in the DI growth in our average revenue per dealer, it's actually up 9% year-over-year.

So, turning dealer count is certainly our top organizational priority. And the increased value delivery and product innovation and improved sales structure are designed to help turn that around. But I would also signal a bigger growth opportunity that we see once we fix dealer count is penetrating our dealer product solutions across a large robust distributed sales network.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Great. Thanks. And I have a follow-up on what you just said on ARPD. But I did – let me ask you now – let me ask you that first before I ask the marketing question. Alex, just on that last comment on the 3%, I guess that's comparable underlying legacy, is that inclusive of affiliate uplift or not?

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

A

Yes.

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

A

Yes.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

So – okay. So, that's first part of it. And then, the other question is – look, I'm not trying to be nitpicky here. But the ARPD uplift, it sounds like you're getting that, if dealer churn is at your lowest at your largest customers, then you're probably also getting some uplift natively from the fact that your smaller dealers are the ones that are experiencing the highest churn, too. Can you kind of parse that out of the equation?

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

A

Well, what I would say is, conceptually, of course, that's right. But again, to Alex's point, our largest customers are also the ones who are keenly aware of the value proposition we're bringing from a marketplace perspective and they're also the customers who are buying more of the digital solutions because they also see the value prop there.

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

A

Yeah. [ph] I'd – about 61% (00:41:57) of our dealer base were franchise in Q4 and it's about the same exact percentage in Q1. So, there hasn't been any real shift in our dealer base in terms of franchise or independent. I'd also just add on the affiliate comment on ARPD growth. I mean, we're almost – we're a year past our lapping the affiliate conversions. And so, most of that ARPD growth, while it is coming from former affiliate markets, it is new product sales to those dealers. And we've stopped segmenting our view of affiliate versus direct because it was quite a while ago.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

That's fair, Alex. I just wanted to understand the nuance going in there and I – listen, I mean, it doesn't really matter what the nuance is on the affiliate side as long as you're getting the benefit you expected to see [indiscernible] (00:42:49) of the story, right? So, the last question I have just on marketing and then I'll step aside is – look, I guess, maybe to ask another question a little bit differently, given the strength that you're seeing in the channel right now and if you believe that you have just an innately stronger offering in the marketplace right now, given that 2019 in general is I think people viewing it as sort of a reset here, why not lean in now harder on the marketing side [indiscernible] (00:43:21) for higher LTV customers over the next few quarters to kind of set the table for what – I think you guys are looking at pretty happily to get to 2020 in affiliate conversions and everything else?

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

A

Well, if you look at our sales and marketing line, we actually did have a fairly significant step-up in our performance marketing channel. And then, when you add in the organic improvements that we've gotten, we've got really strong trends on the traffic and the value delivery side for dealers. Most of the sales and marketing improvement and operating expense came through our sales reorganization and transformation. And so, that was significant – cost take-out in the business. And so, that probably mutes some of the increased performance marketing investment that we are generating in Q1 and plan to sustain throughout 2019.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Got it. Great. Thanks for all the color, guys. I appreciate it.

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

A

Thank you, Dan.

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

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Thanks. Good morning, everyone. Most of mine have been answered at this point. I guess, as it relates to ARPD, I know, Alex, you're not keen to sort of break it out with or without affiliates. But just trying to get some sense as to the base business despite all the good trends in the business, was that flat, down, up on the base business excluding DI and affiliates this quarter?

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

A

So, again, I think the best way I can answer that question is not just pointing to the growth for the quarter but then talking about the month of March where we would be lapsing those – at least, the large affiliate conversion that happened last year. And we still saw growth in ARPD year-over-year in the month of March. So, there is strength there, again, going back to the solutions strategy.

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

A

[indiscernible] (00:45:28)

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. Okay. And then, help me understand maybe a little bit more the sales transformation. It sounds like that created some churn, certainly, amongst your biggest sort of franchise dealers. But those are exactly the kind of dealers that – if I'm not mistaken, the transformation is sort of seeking to address and grow. Can you just kind of walk me through why that causes churn? Is it just a matter of my salesperson left and I liked him or her? Or what was the – what was sort of the impetus for that?

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

A

Yeah. I think that's – well [indiscernible] (00:46:04) that's right. I mean, this is still a very relationship-oriented businesses and we have great people – even those who were impacted were great, great people. But we needed to make a capital allocation shift towards traffic generation and product investment. And we think we can – and we have centralized a lot of our key support functions, so that our sales team can spend more time meeting with the customer and less time compiling reports, generating data and analyzing performance.

And so, now, all of our field reps have this robust inside performance management team that they're able to quickly [indiscernible] (00:46:43) to the dealer that they're visiting all the data they need to facilitate the conversation and shift us from defending our value to talking about our new solutions. And so, the initial blowback when we took out the [ph] costs on sales (00:46:58) was that Cars.com is cutting back. I don't think dealers understood that, while we were cutting back on the people side, we were making very deliberate investments to traffic and product improvements. And now that word is getting out that we're not cutting, we're actually investing differently, I think dealers are starting to appreciate that our value is good and we're certainly a great partner for them to still do business with.

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. And then – thank you for that. And then, sort of along the investment lines, your capital allocation, free cash flow this quarter I think was split approximately between share repurchase and debt repayment going forward. Is that generally how we should think about what you're going to do with that?

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

A

Yeah. I think, for the time being, that's right. That is the strategy that we put forward.

Steve Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. Thank you.

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

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Hi. Thanks for taking the questions. I just wanted to touch again on the Google algo change. So, you weren't getting credit for the [indiscernible] (00:48:10) on your site the way you should have [ph] been. From here, (00:48:14) are there areas to kind of continue drive that gap from the competitors and improve SEO beyond kind of now getting credit?

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

A

Well, I think we are starting to get credit in dealer CRM systems. I don't think public market investors have dug deep enough into how this shift in traffic is going to impact the dealer value systems that dealers are pretty [ph] maniacal (00:48:40) about looking at. Dealers are sending me their KPIs for Q1 and they're seeing decreasing value from competitors and increasing value from Cars. And so, it's hard to see that when total volumes are up. But on a per dealer basis, I think dealers are starting to see the shift in value creation and who is driving more year-over-year versus less. And I think that's taking pressure off any pricing issues we had a year ago. And then, I think, certainly now, it's shifting our conversation with dealers in terms of what else do you have, what else could you – could I do with you, which opens the door to talking about Cars Social or Dealer Inspire products and services. And that's a welcome change, moving from back foot to front foot in our customer conversations.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Great. And then, I guess one follow-up and segueing to kind of the other digital products you're offering [indiscernible] (00:49:38) in kind of a more fragmented market against maybe local or regional agencies, have you seen any kind of competitive reaction from them as Cars.com [ph] leaned more (00:49:48) into that segment?

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

A

No, we haven't seen anything there. I will tell you that one of the opportunities that we're excited about is using Dealer Inspire's programmatic business and their ability to buy traffic. They've been running campaigns now in the open National ad revenue positions on Cars.com on behalf of both local dealers and local agencies and Tier 2 clients and seeing material improvements in the campaign performances in our ecosystem versus one [ph] of their booking – the (00:50:23) other media that their clients are buying through Dealer Inspire.

And so, now, I think both agencies, Tier 2 advertisers are realizing they can buy Cars.com traffic through Launch Digital Marketing, our DI performance marketing group, and they're seeing that performance improvement. So, that could be one way that we mitigate some of the National headwinds we're seeing in 2019, if we can get more volumes through that business.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Got it, got it. Thank you for taking the questions.

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

A

Thank you.

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

Marvin Fong
Analyst, BTIG LLC

Q

Hi. Thanks for taking my question. First question, just following up on what you're talking about with higher-quality lead, are you actually observing conversion rates going up [ph] from your leads (00:51:15)? And if you are, could you give us some sense of the magnitude of that? And then, I have a follow-up.

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

A

Sure, I can. The one of the changes we made last year is starting – as we did the sales transformation, we wanted to show the dealers that we're going to hold ourselves accountable. So, we started partnerships where we're actually getting real-time data access to our dealer CRM systems. We certainly also are pleased with third-party companies like [ph] DataDriven (00:51:43) who are aggregating that data and providing that to us in a real-time fashion. So, we're seeing what our dealers are seeing in current period and the trends that we're seeing in the CRM systems that we're directly accessing or through third-party audits like [ph] DataDriven (00:52:00) are both showing the similar trend which is a very deliberate improvement in lead quality and improvement in the dealers' Net Promoter Score of their satisfaction and an improvement in their likelihood to maintain relationship with us based on that data. So, we track in those three ways and again consistent trends across the board.

Marvin Fong
Analyst, BTIG LLC

Q

Okay. Great. And my follow-up question, just on the listing, the new car listing is down 13%. So, that seems like a greater decline than your direct dealers. And my understanding is that vehicle inventories, industry-wide, are quite high. So, if you could just sort of give more color on that dynamic. Why do you think it is that the new car dealers appear to be listing fewer cars than last year on the site even though their inventories are up? Thanks.

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

A

Yeah. Certainly, the majority of our value delivery systems to dealer on the used car side, so we don't have 100% of our dealers participating and uploading their new vehicle inventory. So, I think you may be just getting a mix change there in terms of the percentage of dealers that are uploading all their new car inventory. Usually, that happens when you get new dealer enrollments. They'll start with the used car inventory and then over time will work to get their new car inventory listed and featured. But I don't have more data on that to provide any analytical support behind it. I do think that OEMs have not introduced all of their models. But this summer, there's a number of launches that are happening with OEMs. And so, I could see those numbers improving in new car inventory volume in the summer.

Marvin Fong
Analyst, BTIG LLC

Q

Okay. Great. Thank you. And congratulations on all the progress you guys have been making.

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

A

Thank you very much.

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

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Yeah. Becky, can you just talk – take me through the math of how you got to direct down 14%? I think you said 14.1% organically.

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

A

All I did there was I excluded the revenue from our Dealer Inspire business. And then, I also excluded the $13.2 million of retail revenue that shows up in that direct line that came from the affiliate market conversions of a year ago. So, that's a gross number, of course, because there's a corresponding offset in the wholesale line.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. I missed the $13.2 million. And then, finally, you gave the – I can figure it out myself. But you gave the mobile traffic, 71% of total versus 65%. Was that about a 30% growth rate in mobile?

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

A

Yes, that's right. It was just, yes, about 30% growth rate on a year-over-year basis.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. Great. Thank you.

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

A

You're welcome.

Operator: There are no further questions in queue at this time. I would like to turn the call back over to Alex and [ph] Doug (00:55:18).

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

Thank you for joining our call today. Have a great weekend.

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