09-Nov-2020

Cars.com, Inc. (CARS)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Cars.com Third Quarter 2020 Earnings Conference Call. Hosting the call this morning is Alex Vetter, Chief Executive Officer; and Sonia Jain, CARS' Chief Financial Officer. This call is being recorded and a live webcast can be found at investors.cars.com. A replay of the webcast will be available until November 23rd. A copy of the accompanying slides can also be found on the company's investors' site. Following today's presentation, there will be a question-and-answer session with Alex and Sonia.

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

Kamal Hamid

Director of Investor Relations, Cars.com, Inc.

Good morning, everyone and welcome to our third quarter 2020 conference call. Before, I turn the call over to Alex, I'd like to draw your attention to our forward-looking statements and the description and definition of non-GAAP financial measures, which can be found in our presentation. We will be discussing certain non-GAAP financial measures today including adjusted EBITDA, adjusted EBITDA margin, adjusted net income, and free cash flow. Reconciliation's of these non-GAAP measures to the most directly comparable GAAP measure can be found in the financial tables included in our earnings press release in the appendix of the presentation. For more information, please refer to the risk factors included in our SEC filings including those in our Annual, Quarterly, and Current reports. We assume no obligation to update any forward-looking statements or information as of the respective date.

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

T. Alex Vetter

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

Thank you, Kamal. Let me start by saying that I'm very proud of our performance this quarter; it has demonstrated the resilience of our business and the dedication of our team. We remain relentless in our focus on customer ROI and value delivery, expansion and execution of our digital solutions strategy, and a disciplined focus on profitability. This resulted in momentum across the business and is apparent in our results; strong traffic growth and quality lead conversions, increased dealer customers and ARPD expansion, and we're back to adjusted EBITDA growth. It was an impressive quarter; and building on that success, just two weeks ago, we achieved another significant milestone by refinancing our debt. We now have greater flexibility to make appropriate investments in the business going forward. Sonia will comment further on the refinancing in a few minutes.

Although operating in a pandemic environment presents challenges, the upside is an accelerating trend of digital adoption by consumers and dealers that play to our core strengths and product solutions. Consumers increasingly want to complete more of their car shopping online from the convenience of their homes and dealers are quickly ramping up their solutions to capture this opportunity. Our business is well positioned to enable our industry to accelerate this shift to a digital-first strategy.

We delivered two consecutive quarters of dealer customer growth and had momentum behind us to deliver a third if not for COVID. We grew our customers in Q4 of 2019 and Q1 of 2020, and we also managed the pandemic better than most. After the second quarter COVID impact, we added 97 new dealers in the third quarter of 2020 including growth in both marketplace and web solutions customers. We exited the quarter growing to 18,130 dealer customers as competition went backwards. Retention rates are at an all-time high and improved sequentially each month throughout the quarter, and dealers increasingly benefited from the reliability of our high quality traffic, sales leads, and innovative digital solutions.

Throughout the pandemic, online shopping soared. Leads and contacts through our digital platforms also increased bringing record value to our dealer partners.

Historically, we have consistently driven walk-in traffic that dealers didn't capture in their CRMs, but with physical showrooms closed, consumer volume naturally shifted to more visible digital channels making our value even more obvious to dealers.

Dealers commented to us that despite dropping Google search spending and all traditional media, Cars.com replaced that volume on a fraction of the cost. This digital dynamic opened up even more opportunity for our digital solutions strategy, as dealers wanted to know what else can we do to help them capture more sales.

Our digital solutions continue to grow significantly with website customers now totaling over 4,000 including more than 250 GM websites launched as of September 30th. We expect to launch half of the contracted GM websites by the end of the year. With every new dealer website launched, the accumulation of subscription revenue builds throughout the year and establishes a strong starting point for 2021 revenue growth.

Further uptake on our FUEL product continues to accelerate since its launch this past February. FUEL is ARPD accreted, and on track to be the fastest growing new product launch in our company's history. Online Shopper and Conversations also continue to grow as dealers are now proactively seeking these digital tools.

The number of website solution customers purchasing Conversations or Online Shopper increased substantially on a year-over-year basis. With ARPD up 4% quarter-over-quarter adjusted for second quarter invoice credit, it is increasingly clear that our diversified suite of products is offering meaningful value to our dealer customers and contributes additional economic value to CARS.

We continue to deliver strong traffic growth with 10% year-over-year increase in both average monthly visits and unique visitors. We also delivered continued robust lead growth despite reduced marketing on a year-over-year basis. The percentage of our traffic generated organically in the third quarter increased by 5 percentage points year-over-year to 76% demonstrating the strength of our brand which consistently ranked number one amongst our competitive set in Millward Brown's total brand awareness scores.

Editorial content also continued to be an important driver of our high-value organic traffic and a key differentiator in delivering a robust user experience for car shoppers and sellers. Our original content strategy is winning favor with dealers as competitors just bid out search volume and sell it back to the dealer where Cars.com has a unique audience that can't be replicated and is incremental to the dealer's bottom line. This is most evident in our high concentration of organic traffic and our overall marketing efficiency which is a sustainable advantage.

That said, we judiciously increased our investment in marketing relative to Q2, but the spend remained well below normalized levels due to our strong organic traffic momentum. We will continue to make deliberate marketing investments focused on high quality channels to ensure our dealers finish the year with strong results.

The retail sales environment show signs of continuing strength in both the new and used car markets. While new car sales for the first nine months of the year were down 19% compared to the prior-year period, September new car sales were up 6% and SAAR estimates for 2020 are inching back up to the 16-plus-million level we saw at the beginning of the year.

Used car demand also remains robust supporting double-digit year-over-year pricing growth. New and used car demand is being driven by buyers choosing car ownership over mass transit and ridesharing services, and improved credit conditions that make car payments more affordable.

Our roughly 50/50 inventory split between new and used cars in our marketplace provides us with resiliency and the ability to meet the demands of all shoppers, and support our dealers and OEMs with reliable value that's vital to their success.

Dealers are leveraging our digital solutions allowing them to operate on reduced staffing levels and are reporting record profits. Our business model continues to perform well in this environment with dealer customers becoming more adept at operating virtually. Our high quality, largely organic traffic, strong lead conversion, and expanding suite of high ROI solutions have driven all-time high retention rates. And the Q3 increase in net new marketplace and solution customers is a resumption of our pre-COVID momentum. Growth will come from both ARPD expansion as dealers adopt more of our solutions and continued improvement in dealer customers. This quarter, ARPD rebounded back to pre-COVID levels and grew slightly on a year-over-year basis.

Our differentiated strategy to bring digital solutions to our dealer base through a robust sales platform is best demonstrated by the success of FUEL. FUEL is a unique, high ROI, targeted video advertising solution which generates higher returns than the expensive, dated, and wasteful linear TV on which the auto industry spends approximately $10 billion a year.

Since its launch earlier this year, FUEL has proved to be CARS' fastest-growing new product introduction and is selling out in certain geographies. FUEL takes the high-quality, pure end market audience generated from Cars.com and allows dealers to run targeted video messages via OTT and social media platforms, providing alternative to broadcast TV that is far less expensive, far more effective, and far more efficient.

Continued FUEL sales growth and the penetration of dealers and OEMs positively contributes to revenue and profitability with ARPD rates that are substantially higher than the CARS' overall average revenue per dealer. Take a listen to what one of our large franchise dealer customers had to say about the impact FUEL has had on its market share in his own backyard.

[Video Presentation] (00:10:03-00:11:13).

Turning to our OEM business, we are beginning to see not just stability, but also some green shoots while national revenue was down 12% on a year-over-year basis, we saw substantial sequential improvement with revenue up 11% over Q2. We saw signs of strength towards the end of the quarter in OEM advertising, and see further opportunities with auto-adjacent advertisers to capitalize on our growing traffic trends.

In a post-COVID world, as OEM production normalizes, and new products are launched, we believe OEMs will once again be drawn to advertise to our huge, largely organic in-market audience. While Sonia will provide more detail on other operating results for the quarter, I do want to call out the meaningful improvement in our profitability and adjusted EBITDA on a year-over-year basis. We did this despite tough operating conditions by maintaining very strict cost discipline and remained focused on the bottom line by adding value to our users and customers. Our strong results in the third quarter are a direct consequence of actions we have taken to position ourselves for differentiated and sustainable growth.

With the strongest brand in the industry, the highest-valued organic traffic, and the demonstrated success of our solutions, strategy, and resilient business model, we believe that we are well-positioned to build on [indiscernible] (00:12:30) delivering strong results for our customers and our shareholders.

Before I turn the call over to Sonia, I want to provide an update on the actions we have taken in diversity, equity, and inclusion in the quarter. Unfortunately, conspicuous examples of inequality and social and racial injustice continue, but the CARS team remains committed to taking sustainable action in our company, our industry, and in our community.

This quarter, we began our partnership with the National Association of Minority Automobile Dealers. This is an important partnership where we can advantage minority-owned dealers with technologies and tools to better drive business results. And we're partnered with Facebook to help enable these dealers with compelling co-op programs to drive digital sales. As we told you last quarter, this truly is a great opportunity to bring more diversity to the industry. There are only 1,243 minority-owned dealers in the US. We hope to help accelerate faster growth in this small segment of dealers with our technology expertise and the initial response has been extremely promising.

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

Sonia Jain

Chief Financial Officer, Cars.com, Inc.

Thank you, Alex. Revenue for the third quarter of 2020 was $144.4 million compared to $152.1 million in the prior-year period. The decrease was primarily due to a 12% decline in national advertising revenue and dealer cancellations in the second quarter of 2020 largely attributable to COVID and partially offset by continued growth in solutions revenue compared with the prior-year period.

Turning to expenses. Total operating expenses were $125.3 million, 9% lower than the prior-year period if you exclude the $461.5 million goodwill and intangible asset impairment charge. The decrease in total operating expenses compared to the prior-year period is primarily due to reduced marketing spend and the cessation of our affiliate revenue share obligations in the second quarter.

GAAP net loss for the third quarter of 2020 was $12.3 million or $0.18 per diluted share compared to a net loss of $426.2 million or $6.38 per diluted share in the third quarter of 2019. The net loss is primarily due to the $30.9 million previously disclosed noncash charge for the correction of an error related to the calculation of the Q1 valuation allowance. The valuation allowance for income taxes had been established in connection with an impairment recorded during the three months ended March 31, 2020.

Adjusted net income in the third quarter of 2020 improved to $34.6 million or $0.50 per diluted share compared to $21.3 million or $0.32 per diluted share in the third quarter of 2019. Adjusted EBITDA for the third quarter of 2020 was $49 million or 34% of revenue, an increase of 7% compared to $45.9 million or 30% of revenue last year. The increase in adjusted EBITDA is primarily due to reduced expenses, largely attributable to a prudent level of marketing spend in a period of strong organic traffic growth and the elimination of our affiliate rev share obligations in the second quarter.

We expect fourth quarter adjusted EBITDA to be higher on a year-over-year basis as we continue to benefit from the end of rev share payments. We also expect adjusted EBITDA margin in Q4 in the 28% to 31% range as we continue to invest in marketing and talent in order to drive long-term growth.

For the third quarter, average monthly unique visitors and total traffic grew 10% year-over-year. The gain was driven by continued efficiency in SEO, consumer demand for vehicles, and continued adoption of online car shopping. Organic traffic as a percentage of total traffic grew to 76% compared to 71% in the prior year period.

We had 18,130 dealer customers as of September 30, 2020, an increase of 1% compared to 18,033 as of June 30, 2020. This increase is primarily due to an all-time high retention rate coupled with new sales. Of note, we grew marketplace dealer customers in the period. We also continued to grow website customers and currently have over 4,000, up 33% compared to the prior year period.

ARPD grew to $2,183 in the third quarter of 2020, snapping back from the second quarter and up year-over-year.

Net cash provided by operating activities for the nine-month period ending September 30th, 2020 was $96.9 million, up 20% compared to $80.6 million in the prior-year period. Free cash flow for the nine-month period ending September 30th, 2020 was $84.3 million, up 29% compared with the $65.1 million in the prior-year period. Our strong free cash flow generation enabled us to pay down $48 million of debt in the third quarter bringing net leverage down to 3.8 times.

As Alex mentioned, in October, we completed a strategic refinancing of our debt taking advantage of favorable market condition. Our new structure includes a $430 million credit facility composed of a $200 million term loan and a $230 million undrawn revolver. We also raised $400 million in senior unsecured notes which have a coupon of 6.375%. The refinancing extends our maturity date from 2022 to 2025 on the bank debt and to 2028 on the new bond.

From a capital allocation perspective, we remain committed to deleveraging as evidenced by the sequential step down in our net leverage ratio from 4.1 times in the second quarter to 3.8 times in the third quarter. Our goal is to bring net leverage down inside of 3.5 times while continuing to invest in the business. While we expect to grow our suite of solutions through internal innovation opportunistic tuck-in acquisitions should provide compelling complement to our portfolio.

In summary, our strong top line trends coupled with focused execution and cost discipline drove year-over-year growth in adjusted EBITDA and free cash flow. Increased investments in the business together with new digital solutions sales will position us to exit the year with a strengthened, competitive financial position. In addition, the recapitalization of our balance sheet improved our flexibility to invest in and grow the business.

And now, I'd like to turn the call back to Alex.

T. Alex Vetter

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

Thank you, Sonia. As I said at the start of the call, I'm pleased with our Q3 results and the momentum we demonstrated on dealer count, traffic growth, and growth in ARPD. We continue to build on that strength with dealer growth in October as well. Despite the uncertain pandemic environment, we are exiting 2020 with strength in our brand, appreciation of our differentiated business strategy, and the rapid adoption of our digital solutions, all of which positions us for a strong start to 2021.

With that, we'll now open the call for Q&A. Operator?

QUESTION AND ANSWER SECTION

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

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

Q

Great. Good morning, guys. Thanks for taking my questions. Two, if I could. Alex, you talked about how the pandemic is accelerating the trend of digitization of the automotive retail space. You guys clearly had some kind of foresight there when you – when you bought Dealer Inspire, but kind of curious to hear if you can give us any color on sort of how you're thinking about the product roadmap here? Is it kind of just reinforcing the core competencies of DI? Are you focused on maybe more the marketing side of things given the success of things like FUEL, or maybe there are other parts of the dealer operations where you think you get that value and innovate?

And then just a quick follow up on traffic-to-lead conversion; it sounds like that continues to improve, just curious of how sort of sustainable that is? Is that benefiting from the pandemic with people just kind of not going into showrooms until maybe later on in the process or are there things that you guys are doing that's impacting that and to sustain those improvements? Thanks.

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

A

Sure, Tom. Thanks. Well, first of all, I think the consumer trend towards private vehicle ownership is going to be the lasting impact on COVID. Our consumer surveys consistently show that users don't feel safe getting back on mass transit or ridesharing services, and are upgrading their personal or private fleet. So, we think that vehicle sales is going to have a prolonged strengthening as a result of the pandemic.

On the dealer side, a grand experiment was run during COVID, and that was, dealers cutting back all of their marketing budgets, but yet seeing these virtual marketplaces accelerate growth. And so, dealers are realizing that they were generating the same number of sales if not higher on a much more radically reduced marketing and advertising investment. And dealers are realizing they're not going to vie around the marketplace experience. Consumers are going to do heavy research prior to purchase and marketplaces are the best place to do that because of the market-wide and content view.

I think on the dealer behavior, part of COVID has been dealers now proactively contacting us about our digital solutions. So you know that Dealer Inspire who – we've been growing business on a steady basis but there's been an acceleration there because of COVID as dealers are wanting to upgrade their website and/or use more technology. In fact, we launched more websites in the last quarter than we had in any prior. And so dealers are realizing that these digital storefronts are their primary channel. And so we are seeing a nice pick up on that business as well that we see it sustained.

I think the final point I'd say is that, ultimately, the business is performing extremely well virtually. The traffic-to-lead conversion both – it's been organic and inorganic. COVID, certainly shutting down showrooms is driving people to communicate directly through these channels which is giving our value a lot more visibility. But at the same time, we're continuing to make tremendous product improvements that are also helping us get further credit and visibility in the eyes of dealerships. So, yes, I think lots of sustained advantages because of COVID.

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

Q

Great. Thank you, guys.

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

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

I'm sorry. My mic's on mute. Can you hear me now?

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

A

Yes, we can, Gary. Go ahead.

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

I'm sorry. Good morning, everyone. Sorry, I had my phone on mute. Hey, when you talk about a back to historical level of operating expenses in – going into Q4, I mean, could you give us maybe a range of what that may be?

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

A

Yeah, sure. Thanks for the question. This is Sonia.

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Hi, Sonia.

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

A

The areas where we're really looking to invest in in Q4 are in marketing, and then really in talent around our solutions strategy, completing data, and innovation broadly speaking. I think when you think about marketing, in particular, we expect, in Q4, to have marketing spend kind of consistent with what you might have seen from us in Q1. Now bear in mind that that number is sales and marketing line. There's a sales component to that. So when you look year-over-year at the sales and marketing line, it may appear to be flattish but it's a little bit of a mix shift with some permanent savings in sales, and some potential additional investment in marketing.

And then bear in mind it's a highly competitive environment, and we evaluate marketing on a regular basis. And so to the extent there are opportunities to gain additional efficiency there, we're absolutely well, and as Alex mentioned, we think we have a lot of just built-in benefit with the strength of our brand and content. But that might be full color.

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Yeah. That does help. Are you giving the Dealer Inspire revenues on a quarterly basis anymore?

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

A

We're expecting to continue to see that business grow. And frankly, that is one of the growth engines of the business. I'd point out that while it comes, it does come with slightly lower margin. So it does impact margins a little bit as we continue to grow that business. What we believe that longer term, it is part of our diversified strategy and is a very sticky business that will continue to provide value to dealers and frankly to us as we continue to build that relationship there.

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. I want to just ask a couple of questions on these digital solutions which seem to be accelerating, but the websites you talked about, the number of placements there. As far as things like FUEL, Online Shopper, Conversations, those are coming off fairly low bases. Could you maybe just share how many dealers have adopted each of these solutions?

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

A

Yeah. I mean, on FUEL which just started this year, we're talking just under 200 dealers...

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay.

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

A

...but significantly higher average revenue per dealer, Gary. So...

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Right.

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

A

...very accretive to the business. And, again, we're not having to add more sales expense to bring these new solutions to market. We're running them through our existing platforms.

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Right.

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

A

I think Online Shopper and Conversations got a lot faster acceleration during the COVID pandemic. And so, you're talking about a 1000 plus dealers using those solutions...

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay.

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

A

...partially bundled with the website offering.

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

So that's very good traction. I guess the question I have for you is this, Alex, because again you're not making more dealerships, and going out and trying to kind of gain market share among dealerships is very difficult thing to do. But if you take your average revenue per dealer just based on your subscription – your model, and then what would be the lift if a dealership took a website, FUEL, Online Shopper, and Conversations. But just trying to get an idea of how revenue accretive are these solutions to your – to a dealership, to your average revenue per dealer, or just the dealer that took your Cars.com listing offering?

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

A

Yeah. So, if you think about the ARPD of some of our DI products, the website on average is going to bring you, call it, in the neighborhood of $1,100 of incremental ARPD and with the add-ons that we have between Conversations and Online Shopper, you could easily double that amount. So, if you're thinking about an existing dealer substantive opportunity to improve the ARPD through just the incremental website and upsell sales.

FUEL, as Alex mentioned, has an ARPD at a minimum that is multiples higher than our average monthly ARPD. That's a product that's actually sold on a zip code basis. So...

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Right.

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

A

...if RPD can flex up substantially depending on the number of zip codes with individual dealers interested in.

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Right. So, it seems to me that your marketing thrust, your sales thrust here has got to be to cross sell these solutions.

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

A

It is, and it's coming through in the numbers, Gary. I mean, if you look at the sequential improvement in ARPD, the strategy is working. We're getting incremental take rate in dealers wanting to spend more money with us to garner a higher share of opportunities and sales. And so we're seeing a nice, steady acceleration in our ARPD growth.

Gary F. Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Yeah. That's great. Thank you so much.

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

Daniel Powell
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thanks so much for taking the question. First question, around the net adds that you saw in the quarter, just curious if you can you help us kind of breakdown if there was sort of even distribution across marketplace and solutions net adds in that number? And sort of how that compares to the net growth that you're seeing so far in October? And then a follow-up.

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

A

We grew both marketplace and solutions only customers in the quarter. So, we were pleased to see both businesses step up in terms of dealer count. The net dealer additions skewed more towards franchise dealers than independent. We saw bigger gains in our franchise dealer mix.

Daniel Powell
Analyst, Goldman Sachs & Co. LLC

Q

Got it. And then, Sonia, as it relates to the guidance on margin for Q4, realized there's reinvestment around sales and marketing, but just curious how much of the sort of negative mix shift to some of the solutions is also weighing on the margin expectations for 4Q? Thanks.

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

A

Yeah. That's certainly going to be a contributor here. The solutions business does require upfront investment in terms of the launch of website before we can really start recognizing the revenue associated with that. As that business scales, we'll expect to see an improvement there. But for the near term, we're really excited about the growth and the long-term health of the business that's going to drive, but it does have, it does flow through to margin.

Daniel Powell
Analyst, Goldman Sachs & Co. LLC

Q

Great. Thank you, both.

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

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Great. Thanks for taking my questions, guys. I just want to start out on the national advertising business. You kind of hinted at sequential improvement, but just kind of want to nail that down with improving inventory and OEMs re-upping their ad budget for Q4, would you expect the national business to be up sequentially?

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

A

The national business is a little bit spotty or harder to predict because OEMs come in and out. The business does, Lee, tie a little bit more to model launches with OEMs. So, as OEMs launch new makes or models in a period, we can see an increase in overall spending. And we saw some nice sequential month-over-month pickup in national for September and heading into October. So, we feel good about the signals we're getting and then a big percentage of that business also is bought on an upfront basis for next year where manufacturers are committing to us, set times at the year that they want to promote new products, and we're seeing a very healthy discussion happening there for 2021 as well. So, we feel good about the stability of the business and then hopefully moving it towards growth.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. And then, on the slide deck, you put out some fairly significant double-digit growth drivers to kind of highlight the shift to digital. As we layer in kind of all these incremental revenue drivers on top of a fairly stable marketplaces business? When would you guys kind of expect to see year-over-year revenue growth inflection?

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

A

When we started the year, we were on a path for growth in the second half of this year until COVID hit. And obviously that delayed all of our plans temporarily; but if you look at the trend on what we have been doing, we grew our dealer count in Q4 of last year; we grew it again in Q1 even with some of the pandemic starting in the first quarter. And then to see the business snap back both from our discounts and now accelerated solutions growth, we think we're back on track.

Obviously, the COVID period delayed our achievement of that growth objective in the second half of this year, and will push us closer towards 2021. We're just not giving revenue guidance this time because with the pandemic still being so unsure, it makes predicting that revenue trend much more difficult.

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

A

Yeah. And the only other thing maybe I would add there is that, in our subscription model, you do need to see that revenue build over time. So, to Alex's point, the improvement in ARPD, growth in dealer count in three of the last four quarters, right, and one of those was a COVID quarter, all point to really strong underlying strength.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Got it. And then last question, you've seen kind of the secular shift to online and consumers obviously browsing a lot more, and that gives us traffic for sure, just on an organic basis, but do you guys get a sense that you're continuing to see traffic share gain? I know, in prior quarters, you kind of have highlighted that as well, but noticed it was missing from the commentary. Maybe quantify or qualitatively speak about perhaps the share gains you're seeing across just the net traffic growth from your peers?

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

A

Yeah. The share gains have been very vivid throughout the past year and changed. We've grown particularly when you look at just SEO growth. There's been nobody that's taken more market share in terms of organic traffic which that traffic has incredible conversion and is of the highest quality. So, set aside the fact that it's coming to us free in an organic capacity, but it's converting extremely well.

And so the right mix of traffic has been in our favor now for a year, and we hope to sustain that when we launch our new beta platform early next year so that remains. Where we're obsessed is continuing to generate high quality content that wins a disproportionate share of organic traffic.

I think the larger traffic picture is somewhat hard to predict and those are our lesser competitors that don't have the diversified strategy or differentiation in their business, and I think they will have a hard time sustaining growth next year particularly if vehicle sales start to fall a bit. There's going to be a more intense competition for a lower volume of sales. And because we have a differentiated strategy, we just think we're really well positioned to take more share from others who say, basically rely on search engine marketing arbitrage to generate value.

We don't have that problem with the majority of our traffic coming to us organically or directly, we're able to sustain our revenues and our customer relationships based on our own merits as opposed to having to drive up spending to generate volume, and so I think that's one of the material advantages that will set us up well for 2021.

Lee Krowl
Analyst, B. Riley FBR, Inc.

Q

Great. Thanks for taking the questions guys.

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

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you for taking the questions. I guess just first on, these traffic share gains, can you talk about, I guess, the lead conversion to Cars.com and then the conversion at the dealership. So actually selling a car and I guess how do you bridge kind of the traffic volume against kind of the supply constraints that we've heard of in the industry and how are these conversations coming up in terms of ARPD when you are talking to dealers? Thank you.

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

A

Sure, Nick. Well, first of all, the lead conversion improvements have been substantial. And again, I'll point to the high concentration of organic traffic. So we're capturing a natural spring, if you will, of car buyers who are using the platform and contacting dealers directly coming in through organic channels. And so, we're seeing our value delivery increase substantially. And then keep in mind, with dealer showrooms closed for a huge part of the country; all of that activity that was physical traffic has now shifted to digital conversion as well. So dealers are getting almost a [ph] two-four (00:38:23) lift in terms of our traffic value and visibility.

I think the third thing is dealers have cut back a lot of their direct spendings most notably on Google. And so they're able to look at our volume, and how it converts, and attribute more of those sales to our platform versus, say, last-click attribution, or attributing sales to their own website because they lost sight of where that traffic source originated from. And so I just think dealers are understanding our value better today than ever before that comes through in our record retention rates, lowest cancellation rates we've ever seen in the business. And now you're seeing some dealerships come back because it's certainly a lot cheaper to advertise on our marketplace than to try to drive all the traffic directly to the store. And so those things have really come through in our value delivery.

And on the traffic share gain, I mean we have a differentiated strategy, we're laying down meaningful lines of new product revenue whether that's through Dealer Inspire, our FUEL business, and generating that revenue allows us to reinvest back into the business and the brand on a more sustainable way. So I think we're really well positioned in the marketing war chest department so to speak, and I'm really pleased with the organic trends and how we're generating our value vis-à-vis our competition.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Got it. Thank you.

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

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Thanks. Most of mine have been answered at this point. But I just want to make sure I got the math on GM correct. So, my math is just under 200 or so GM sites launched during Q3 which sort of get to the above half that you talked about. That would imply north of 500 that need to be launched in Q4 which seems like a steep ramp. Is that right? And then assuming that's doable based on where we are in the quarter.

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

A

Yeah. So, let me clarify a little bit. We had come out with just over 800 incremental GM websites. We've launched over 200 of those and we expect to be at kind of that halfway mark by the end of the year obviously, slight delays related to COVID during Q2, but we're finally ahead there with good traction.

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Okay. And just as it relates I guess to Q4 revenue guidance, you don't seem to – understandably I guess to some degree, but you don't want to give revenue guidance or dealers net adds, net churns, but the business seems to have a lot of momentum. We're halfway through the quarter, it is a subscription business. So I guess just directionally, would you anticipate being up vis-à-vis Q3? Any color there would be great.

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

A

Yeah. We ended – obviously really excited to have ended Q3 up on dealer count. I think importantly seeing that dealer count improvement on both the marketplace as well as the solutions side of the business, DI is back – a nice way to start Q4, and as Alex mentioned, we had strong October from a dealer count perspective. DI has continued to grow, and we saw some good traction in the national business when you look sequentially at performance at Q2 to Q3. So a lot of really positive signs when you look at just the last couple months of performance.

Steven Lee Dyer
Analyst, Craig-Hallum Capital Group LLC

Q

Got it. And then just the sort of the dearth of inventory, are you seeing or you think that there's still a negative impact to you guys just because a lot of dealers don't have anything to sell [indiscernible] (00:42:22) or not to sell. So certainly not a lot of reason to go on and spend significantly whether that's national or on the individual dealer level?

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

A

I think keeping the industry churn rate going is something that everybody is trying to contribute towards. We've seen an increased demand from dealers to buy trading products so that they want to source vehicles directly through our marketplace. We have higher concentration of private sellers listing their car for sales than most of our competitors. So dealers are talking to us about buying those opportunities and getting access to that inventory. So that's an opportunity.

I think that second thing we're seeing just record dealer profitability. So dealers aren't in a typical Q4 mindset, which is about cutting back to hit a year-end profit target. They've been able to hold their retail pricing and generate extraordinarily high profits because they're not spending to the degree they have in the past. But there are also times that these marketplaces are rich sources of opportunities, and certainly are very affordable to spend a few thousand dollars to list on a marketplace. So, even with the inventory shortages, there is a battle for market share out there and we're a fertile ground for it.

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

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Yeah, thanks. Just on the ARPD strength, Alex, and you sort of touched on this in your remarks, but is there a way to sort of ballpark the contribution from new services as opposed to the traditional listing services in terms of both the absolute level and the growth of that number?

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

A

Sure. I'll point to just the ARPD growth as mostly driven by product mix and franchise dealer mix. So, we are getting more franchise dealers, subscribing not only to our marketplace, but also to our solutions platforms. And so, you're getting two mix shifts happening there in our ARPD, which is leading to sequential quarter growth as well as we saw that continue into October. And we were pleased to also grow our dealer count in October. And that's followed that same trend.

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

A

Yeah. And maybe just to add there, it might be – it might be helpful as you roll some of the numbers. We ended with about 4,000 web customers in Q3. And if you – if you think about DI, the business, it's always been growing on the customer side. We did see kind of a return to growth on the top line as well in the high teens, so as you think about the revenue, we're generating there, I just wanted to make sure you had that piece of information.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

And I guess just as a follow up to mix. I mean are you still seeing these small independent dealer struggle that's been mentioned by some of your competitors? And are some of them still churned off at this point because they just don't have – they can't get inventory, they don't have marketing budget? Or is that looking a little bit better going into the fourth quarter?

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

A

I think we've always skewed towards the larger independent dealers as opposed to the long tail smallest independent. Hertz should be probably the best example of losing smaller dealerships because Hertz has I think almost 100 locations with very few cars, and them declaring bankruptcy. That will hurt us on dealer count, but not very much on revenue, right, because we Hertz stores have very few pieces of inventory per location. So, no, besides that one example, we're seeing a healthy independent dealer base driven by the strength in used cars and retail pricing.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Great. Thank you.

Operator: [Operator Instructions] Your next question comes from the line of Marvin Fong from BITG. Your line is open.

Marvin Fong
Analyst, BTIG LLC

Q

Great. Thanks for taking my questions. Just kind of build on that last question, so, we are still down, I guess 800 dealers on a net basis from last quarter. Just curious, how are those conversations going in terms of winning some of those dealers back? What do you feel is holding them back now that the environment is a lot better than I think we would have guessed a couple of months ago? And then I have a follow up.

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

A

Yeah. I mean the conversations are actually going quite well. In fact, one of the big shifts that's happened in the past, call it, 120 days is the number of inbound dealer inquiries we get. We used to be 100% outbound sales focused, and again, part of the COVID response is now we're actually getting dealers calling us directly about engaging.

And so I would signal that as a real shift in dealer awareness on what's working out there and this is a small community. Dealerships talk. They actually understand value really well. And dealers are starting to realize that we are much better than some of the competitive services which are just search arbitrage offerings where we have high organic traffic concentration that dealers can't buy elsewhere. And so that's leading to, I think, a very healthy discussion about visibility of our value vis-à-vis other services.

What was your second question there, Marvin?

Marvin Fong
Analyst, BTIG LLC

Q

It was on FUEL. I know it's early days, but it looks like it's doing very well. Just curious if you're already able to kind of calculate and compare how efficient it is, say, from a cost per lead or cost per sale basis, very difficult to even track that for like traditional media. But how does cost per lead for FUEL compare to perhaps other forms of digital marketing or even a lead through the marketplace? Thanks.

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

A

Yeah. We wanted to feature the example on the call of how a dealership is looking at their market share overall pre and post FUEL. And they shared some pretty amazing results in terms of how they saw material share shifting in those geographic markets. And that's an important distinction for FUEL.

Because we sell it on a geographic exclusivity, dealers can actually benchmark their market share down to the zip code level. And we've seen enormous renewal rates already from the dealers who started with us in FUEL in Q1, and largely not seeing much of any attrition yet because dealers are able to see notable share shifts in their overall market share as measured by retail sales. And it's video messaging, so we're not demanding consumers fill out forms, and we are very upfront about that with dealers is that, look, you're tapping into the Cars.com marketplace audience ID, and by doing that, you are able to message with frequency about why buy from your dealership vis-à-vis someone else's.

And so this is going to be a smaller segment of dealers, call it 2,000 dealerships who actually know digital works and won't be obsessive about a digital KPI, but more will trust that this will shift market share in their favor. And that's why we're commanding materially higher ARPD. An average FUEL subscription could be anywhere from $8,000 to $10,000 a month for a geographic zone. And dealerships aren't balking at it because they know how much a share point would cost them to generate on their own.

Marvin Fong
Analyst, BTIG LLC

Q

That's terrific. Thanks, Alex, for all that. Appreciate it.

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

A

Thank you.

Operator: Your next question comes from the line of Tom White from D.A. Davidson. Your line is open.

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

Q

Great, guys. Thanks for letting me back in the queue here. Alex, you mentioned a couple of times this dynamic where dealers, maybe during kind of the height of the pandemic, cut a lot of their marketing in areas – kind of direct marketing in areas like Google, and then were able to replace that traffic via Cars.com and I think you said sort of at a fraction of the cost. And I guess I'm curious whether that dynamic has you rethinking at all how you think about unit pricing in the core listings business? It seems like a lot of the growth you're kind of forecasting in revenues for the future come from kind of new product adoption, but is it possible that you guys might be able to kind of find or extract some pricing power out of what's happened here recently?

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

A

Thanks, Tom. Well, certainly, the restoring of our rate strategy post pandemic shows a lot of durability in our pricing. Right? We were able to restore after the COVID discounts, go back to full pricing relatively quickly. And then, we saw dealers increasing take rate of new solutions. And so, the fact that we're growing our dealer count, and you're also seeing sequential period improvement in ARPD shows that we're not having to discount to generate volume. We're holding our rates and we're getting more product sell-through at the same time while we're growing dealerships. And that's going to produce a very healthy trend going into 2021.

I think in terms of the marketing experiment, dealerships cut back heavily across all their advertising and marketing, but saw these marketplaces generate much more volume during the COVID period and also beyond. And so, I think they have a greater appreciation that this is traffic that they have to compete for. And keep in mind, Tom, we see very clearly through Dealer Inspire. I basically got 4,000 dealers where I can look at competitive traffic and what is converting for dealers. And we see very vividly number one, that Cars.com generates 2 to 3 times as much traffic into the dealer's website versus other marketplaces; and number two, what we see is our traffic is converting at almost 4 times the rate of all the dealers other website traffic sources combined. So, we see both our value in volume and in quality through the dealers' own website analytics. And so, I think our team feels very front foot of our pricing and our value.

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

Q

Good. Thank you.

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

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Great. Thanks. Good morning. Alex, I just want to go back to something you said about creating basically a source of inventory on trade and on the marketplace. I know that there's been a lot of talk in the industry about trying to figure that out. Obviously, things being the way they are now is probably not the way things will be 12 months from now where you can get – used car basically sells in like 24 hours once it hits the lot. But just to the extent that you have an opportunity to expand that. If that is a thought process, I'd love to hear that. And then I want to ask you some more questions about traffic and leads, but let's start with it.

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

A

Sure, Dan. Well, first of all, even though their retail dealer network sells 44 million used cars a year, as you know, there's still almost 11 million cars that are sold, private party, peer-to-peer that sit outside the retail system, and we get a very natural organic stream of those people listing their car for sale on our website every day. And dealerships, to your point, needing to acquire inventory we see that as a new revenue opportunity. In fact, we're in beta right now with pretty healthy degree of dealerships, testing vehicle acquisition products from private parties listing on our website. And so dealers now are looking to us to accelerate the digitization of their buying strategy.

I'd rather buy a car from a private seller than go to the auction and compete with 20 of my dealer friends is a common phrase we hear playback to us. So, we can be a reliable source of inventory for dealerships. And again, we're in pilot right now with that solution and expect to see more from us there.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Got it. Super helpful and then I know you're excited – super excited to talk more about lead growth and traffic growth. I just – you said continued robust lead growth off of 10% traffic growth. I mean could you [indiscernible] (00:55:15) the lead growth faster or slower than the traffic growth without giving us an absolute number?

And then I just want to understand because it sounds like we're getting into Q4, we're not, obviously not back to normalized inventory levels yet. It sounds like you're starting to lean a little bit back more [indiscernible] (00:55:33-00:56:11) would be helpful.

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

A

Sure. You broke up a little bit there, but I think I got the essence of both questions. So, yes, our value delivery and our lead growth has outpaced our traffic growth and that was driven partially by the COVID elevation to all the digital channels. So we got a much higher growth in our lead counts and our conversion rate which translates to dealer value.

I think on the traffic side, keep two things in mind that we have a robust new car business as well. So consumers still vacillate between new and used even up until the day they buy. And so we have a ton of phenomenal new car content. So, as the new and used car market shift back and forth, Cars.com is being heavily sought out for advice.

And then I think also just our differentiated reviews and content strategy. Our expert editorial team is generating critical assessments of all new cars being sold today. And then we've got more reviews than any other platform out there, not only for cars but for dealerships as well.

And so, that content is what's helping us generate a higher degree of organic traffic concentration than any of our peers. And so, as dealers look to who do I get incremental sales from, Cars.com becomes much more valuable because they know that they can't buy that traffic directly. Where other competitors who just take the dealer's money and bid up search and sell it back to the dealerships, that's not going to net them the incremental sales that say tapping into organic traffic well is going to generate for the dealership. And so, I think our traffic strategy is starting to be rewarded, which is why we had dealer growth in Q4. Again in Q1 snap back dealers in Q3, and saw dealer growth again in October this past month.

Dan L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Got it. That's really helpful. Thanks, Alex.

Operator: There are no further questions. I would like to thank everyone for joining the Cars.com third quarter 2020 earnings call. You may now disconnect.