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Cars.com, Inc. (CARS)

Q1 2023 Earnings Call

CORPORATE PARTICIPANTS

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

Sonia Jain
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OTHER PARTICIPANTS

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

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Marvin Fong
Analyst, BTIG LLC

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Cars First Quarter 2023 Earnings Conference Call. This call is being recorded and a live webcast and the accompanying slides can be found at investor.cars.com. An archive of the webcast will be available at Cars' Investor Relations website. I'd now like to turn the call over to Robbin Moore-Randolph, Director of Investor Relations.

Robbin Moore-Randolph

Director-Investor Relations, Cars.com, Inc.

Good morning, everyone, and thank you for joining us. It's my pleasure to welcome you to the Cars' first quarter 2023 conference call. With me this morning are Alex Vetter, CEO; and Sonia Jain, CFO. Alex will start by discussing the business highlights from our first quarter. Then Sonia will discuss our financial results in greater detail along with our 2023 outlook. We'll finish the call with Q&A. 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 operating expenses and free cash flow. Reconciliations of these non-GAAP measures to the most directly comparable GAAP measure can be found in the financial tables included with our earnings press release and in the appendix of our presentation. Any forward-looking statements are subject to risks and uncertainties. For more information, please refer to the risk factors included in our SEC filings, including those in our most recently filed 10-K, which is available on the IR section of our website. We assume no obligation to update any forward-looking statements.

Now, I'll turn the call over to Alex.

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

Thank you, Robbin, and welcome to our first quarter 2023 earnings call. We continue to deliver on our key performance indicators. Revenue grew 6% year-over-year to $167 million, and adjusted EBITDA totaled $44 million, representing a 27% margin, all comfortably within our guidance range.

We achieved these solid results through continued marketplace strength, website growth, the addition of Accu-Trade, and media product upsells, growing ARPD 4% year-over-year. Although the industry remains dynamic with fluctuating vehicle prices and low inventory levels, our customers consistently rely on our marketplace for its ability to attract a significant audience of shoppers and remain dependent on our digital solutions regardless of inventory level.

We remain an industry enabler and do not take possession of inventory. Empowering our customers with digital solutions allowing them to own the last mile in retail. Our audience engagement and traffic trends also remain strong. For the quarter, traffic increased 11% and monthly unique visitors were up 7% year-over-year. The strength of our brand, strong editorial content and best-in-class app resulted in a 7% year-over-year growth in organic traffic, enabling us to preserve marketing dollars as we continue to focus on product innovation.

Building upon our strong value proposition, during the first quarter, we introduced new marketplace subscription packages that seamlessly combine new tools like search expansion that extends the customer sales radius as well as CreditIQ and DealerRater features. These packages enable customers to better leverage our platform capabilities.

We also aligned our subscription pricing with the enhanced value offer that's part of these new packages. Overall reception has been positive with strong demand from dealers opting for our premium tier. As discussed in prior quarters, digital dealers began scaling back their operations last year. Despite this, we still ended the quarter with 19,186 dealer customers, 320 lower compared to the prior quarter and 314 fewer than the previous year. Excluding the loss of digital dealers, customers would have been up on a year-over-year basis. In addition to our marketplace strength, dealers continued to adopt our website solutions as website customers grew to more than 6,100 at quarter end, a 630 customer increase year-over-year.

Accu-Trade appraisal and vehicle acquisition solution is also seeing strong engagement from dealers and consumers. Dealers love Accu-Trade given our proprietary win specific valuations that help pinpoint Accu-Trade in values using real-time supply and demand data. Consumers also appreciate more accurate vehicle values, which reduces the need for negotiation and enables shoppers and sellers to transact with greater trust and transparency. Appraisals increased by 70% sequentially, and we now have more than 600 Accu-Trade connected customers on our platform.

In closing, we continued to deliver strong results with operating momentum. Cars.com is a trusted brand for consumers who overwhelmingly use our platform and our subscription business, coupled with upsell opportunities, deliver strong and stable revenue growth. These solid fundamentals position us well to deliver on our continued growth outlook for the balance of the year.

Sonia?

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

Thank you, Alex. Our year is off to a strong start. Revenue for the first quarter totaled $167 million, up 6% year-over-year. Dealer revenue grew 7% or $9 million year-over-year, driven by websites, media sales and Accu-Trade. We also saw strength in revenue from OEM customers this quarter. However, national revenue, which includes our insurance customers, was down. As a result, dealer revenue growth was partially offset by an 11% decrease in our OEM and National revenue line.

Moving to expenses, our operating expenses for the first quarter were $155 million compared to $147 million in the prior year. On an adjusted basis, operating expenses increased $5 million or 4% compared to the prior year. The increase is due in part to higher product and technology expenses related to the acquisition, integration and launch of Accu-Trade. Also, we continue to invest in our sales and support staff to increase new product sales and fulfillment. This is reflected in our cost of revenue and operations and marketing and sales lines.

While marketing and sales was up year-over-year, we spent less than originally planned on marketing this quarter due to the strong growth in our audience metrics. Traffic was up 11% year-over-year, driven by momentum in organic traffic, which was up 7% year-over-year. We continually evaluate our marketing spend and identify opportunities for efficiencies and lean into the channels that provide the highest return. We capitalize on increased consumer demand this quarter with shifts in our paid user acquisition strategy and enhancements to our app and website experiences.

Net income for the quarter totaled $11 million or $0.17 per diluted share. This quarter's results reflect the $8 million change and the fair value of earn-outs related to our recent acquisitions. Adjusted EBITDA was $44 million, up 6% compared to the prior year and adjusted EBITDA margin was 26.5% of revenue. Margin for the quarter reflects revenue growth, partially offset by the investments to support our growth initiatives.

As Alex mentioned, we recently started to roll out new marketplace packages. These new packages simplify our go-to-market efforts and allow us to deliver more of our platform value to our customers. They also afforded us the opportunity to better align our pricing and value delivery. Early results are showing increased adoption of our higher tiered packages, somewhat tempered by an expected, but modest increase in cancels. So we expect these packages to drive incremental revenue and adjusted EBITDA, which will accumulate as the year progresses.

Now turning to our key metrics that are the foundation for our solid quarterly results. As discussed, dealer customers would have been up year-over-year if not for the additional digital dealer pullbacks. This was not a surprise and reflects their continued operational challenges. Our customer base remains healthy and strong and we ended the quarter with 19,186 dealer customers, and we continue to be focused on cross-selling our customers' new solutions.

Year-over-year, we grew website customers by 630 to a total of 6,100 customers. Although sequential growth in website customers is more muted due to elevated cancels in the quarter, websites and Dealer Inspire dig ad business combined to drive 29% year-over-year growth.

First quarter ARPD grew $95 year-over-year to $2,386, driven by growth in digital solutions, website, and the benefit of a full quarter of Accu-Trade. We expect continued ARPD growth through cross-sell opportunities and our marketplace repackaging efforts. Our subscription business delivers strong and consistent cash flow, enabling us to continue to de-lever our business, while maintaining a balanced capital allocation strategy.

During the quarter, we paid down $19 million of debt, including the $15 million remaining on our revolving loan, which we used to fund the Accu-Trade acquisition in 2022. That outstanding decreased to $463 million, of which, nearly 90% is related to our 6.375% senior unsecured notes maturing in 2028. The combination of adjusted

EBITDA growth and debt paydown resulted in a net leverage ratio of 2.3 times, down from 2.7 times a year ago. We also returned $7 million of capital to shareholders via share repurchases. Our liquidity is strong at approximately $249 million between our undrawn revolver and cash on hand. This provides us with significant strategic flexibility going forward.

Our strong financial performance and integrated platform position us well for continued profitable growth. Looking ahead to the second quarter, we expect to deliver revenue between $168 million and $170 million, reflecting continued dealer revenue growth. While the marketplace repackaging rollout will accelerate in the second quarter, the full benefit will be realized over the course of the second half of the year. And despite OEM green shoots in the first quarter, we remain cautious on OEM and National revenue, largely due to the pullback by our insurance customers and historically lean inventory levels.

It is important to note that in the second quarter, we will fully lap the acquisition of Accu-Trade and will be comping to a period not yet impacted by the digital dealer pullback. Despite this difficult comp, we anticipate growing second quarter revenue by 3% to 4% year-over-year.

Second quarter adjusted EBITDA margin is expected to be 26% to 28%. Our margin outlook contemplates lower OEM and National advertising revenue relative to the first quarter, as well as increased investment in brand marketing to drive growth in the business and awareness of new products.

Building on that, we reaffirm our 2023 full year revenue growth expectations of 3% to 6%. We also anticipate exiting the fourth quarter of 2023 with margins approaching 30%. We are well positioned to deliver on our goals. The strength of our customer relationship, efficiency of our traffic generation and asset light business model will continue to translate into growth and profitability.

And with that operator, we'd like to open the call for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And our first question comes from Thomas White from D.A. Davidson. Your line is open.

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

Q

Great. Great. Thank you. Good morning. Thanks for taking my questions. A couple, if I could. I guess just first on the OEM and National line. I think you said that OEM is maybe perking up a little bit in the quarter, but overall that line is still depressed a bit. I guess, it's largely tied to new vehicle inventories and production schedules, which I guess are improving a bit but are still kind of well off kind of pre-pandemic levels.

I guess what I'm trying to understand is whether you think this kind of the current level of new inventory and sort of the pace of the ramp – is this sort of like the new normal, for the industry that we should expect, kind of, for the foreseeable futures of franchise dealers just kind of enjoyed the last couple of years of tight inventory and high prices in there. And that's kind of factoring into to how OEMs are deciding to, I guess, putting new vehicles out there. I guess that's my first question. And then I got a follow-up.

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

A

Tom, thanks for the question. Look, I don't think it's the new normal in that. What you're seeing in the marketplace is that certainly certain OEMs are trying to better balance production towards demand. And that's admirable to want to have perfect yield and no overproduction. The downside is you've got other car companies that are building ahead of market demand and seeing market share gains at faster levels.

If you look at the Korean automakers, Hyundai and Kia, most recently, they're taking market share because they've got product on the street for consumers to drive and to experience, and they're taking market share. And so while everyone in a certain segment of the market may know exactly what they want and be able to preorder it online, the vast majority of car buying does have a degree of impulse and fitting market need. And so I do believe the industry is going to get back to having more product on the shelf because they cannot possibly anticipate the changing consumer expectations and needs that far ahead of a lifecycle schedule.

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

Q

That's helpful and make sense. Thanks. And just like a follow-up on Accu-Trade. Can you maybe talk a little bit about the product roadmap for that? And I guess I'm under the impression that there's sort of like a, sort of, a beefed up or sort of fuller version of the solution. Maybe that's, that you guys sort of have in the works, just kind of trying to understand what we should expect from that technology and maybe just comment on how you feel it's kind of differentiated versus some of the other offerings in the marketplace?

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

A

Sure. Well, first of all, really excited about the growth we're seeing in Accu-Trade not just for dealerships, but consumers as well. And that we're elevating the industry away from the legacy black box, mystical pricing, what's your trade in worth to a data-driven assessment that's based on real-time supply-and-demand data, as well as the intrinsic health of a car. And so ultimately what that does is it eliminates friction between dealerships and their customers, so that users don't have to drive to three to four stores to know what their car truly is worth. They can do it on their mobile phone. They can use Cars.com to get accurate vehicle values. I think – and we're seeing that in our appraisal volume, up 70% in the quarter. So not only dealers are appraising more vehicles using our tech, but consumers are getting more vehicle valuations through Cars.com.

I think, when you look at the roadmap ahead, we've really got an opportunity here to extend consumer's relationship with Cars.com, because while you may not need a trade in value today, the more we can get consumers to register their cars with Cars.com, long-term that's going to reduce our marketing expense because we're going to have an ongoing relationship with consumers to present them values throughout their vehicle ownership journey. So that's in the pipeline and in the works.

You're also seeing us move more into helping dealer groups trade inventory within themselves. So large dealer groups have told us that they love Accu-Trade, but they'd love to be able to move cars amongst dealerships, which puts in the foundation for where we really ultimately want to go, which is enabling a dealer collective to basically be a dealer-to-dealer exchange, something that is far more efficient than the physical auction and dealerships can trade vehicles both within their groups and within a peer group at a far more reduced cost than the legacy auction model, which we think can be disrupted with technology.

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

Great. Thank you very much.

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

Thank you, Tom.

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

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

Hey, good morning, all. In terms of the dealers, have you – are most of the digital dealers now out of the equation as far as clients? Or could we anticipate continued drips in that segment of the dealer space for you guys?

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

Thanks for the question, Gary. I think at this point, they are largely out of our balance of the year view. So we shouldn't really have any meaningful additional drops on that front.

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

All right. And then you mentioned that dealers would be up with the exception of these digital dealers pulling out. Could you just give us a frame of what that percentage change would have been? Do you have that handy?

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

Yeah, it's a year-over-year. So I think what we mentioned is that if you look year-over-year adjusting for digital dealers or excluding the digital dealer cancellations, we would have been up and I would tell you that, it's on a percentage basis low single digits. But I think the point for us is that the base, the core of the business continues to be healthy. We see a lot of strength with our traditional dealers. And I think, as you may have heard us note on the call, we're actively out in market with new packages for marketplace that actually add additional products to our packages. I mean, that's been well received.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

And that lead into the next question. Could you kind of go into a little more detail on what these new packages are? What they include and why would that be an attractive situation for a dealer to want to take these new packages?

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

A

Sure, Gary. You know, first of all, dealerships love options and presenting them optionality is core to our strategy to meet dealers where they are and what they are looking for and need. And so we have a base program, a preferred program and a premium program. And in classic packaging parlance, there's more features available. The higher in the food chain you go, things like including your own private lender network, having basically more dealership branding in the vehicle detail pages and search result pages that drives more traffic to the dealer's website; the ability to embed DealerRater salesperson connect so that you can connect directly to an individual as opposed to generically to the store; and search expansion, which will optimize dealers inventory in slightly more geographies than they their natural search radius.

So we clearly have put a lot into the premium tier and into the preferred tier. And we're excited because most dealers are gravitating to the higher end, which is going to continue to stimulate ARPD growth. It also shows dealerships that, look, we're not just raising rates, we're adding value. And while we have seen some churn with dealers on the initial presentation of our price increase, once we engage with them and show them all the features that are coming with the higher packages, we're seeing good take rate. So it's early but I think as you know any actions we take here not only adds to nicely to the top, but can flow through to the bottom line as well. And so with our strong traffic trends, we feel very front footed on our packaging initiative.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

So in this packaging initiative, if you have use of your base preferred premier, can we safely assume that all of the prices went up for each of those tiers as to what you're showing the dealer?

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

A

Yeah. That's right.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. Okay. All right. Thank you.

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

A

Thank you, Gary.

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

Marvin Fong
Analyst, BTIG LLC

Q

Great. Good morning. Thanks for taking my question. So I guess, maybe to put another finer point on the new marketplace packages and the ARPD lift, I'm just curious, though, you're reiterating your full year guidance. Was this lift the ARPD contemplated in your guidance from last quarter or is that new? And is this being kind of offset by the weakness, incremental weakness in OEM just to kind of maybe disaggregate if there's been any change in the full year build up to your guidance?

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

A

Thanks. Thanks for the question, Marvin. So we began the repackaging effort really towards the end of Q1. So as you are aware, right, in the subscription business, it just takes time for the incremental revenue to start [indiscernible] (00:23:45) and really flowing through the numbers. And we're very early in the process at this point in time, but again, reception has been, as Alex was alluding to, reception has been positive with a lot of folks opting for kind of our premium tier and effectively upgrading themselves. The price increase or the repackaging efforts are included in our Q2 revenue. It's already baked into our Q2 guidance. And I think at this point, just given where we are in the process, we think it's prudent to kind of reaffirm our full-year revenue guidance.

Marvin Fong
Analyst, BTIG LLC

Q

Okay. And then maybe just to move on, I think the Dealer Inspire, you highlighted that maybe there was a bit of elevated churn there. I'm just curious, website solutions, I would think is typically pretty sticky, given a dealer need the website, right. So just curious, what's happening there, was there any share loss or dealers migrating to another solution or how would you characterize what's going on there?

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

A

Yeah, so we did. We did experience slightly higher cancels in Dealer Inspire websites for the quarter. We do think it's somewhat one time in nature in part for some of the reasons that you talked about. There were a couple competitors in market who are offering, I think, fairly steep promotions that we just didn't want to partake in. And then I think I may have mentioned the other quarter, we've also been working on some of our legacy OEM agreements and just working there both on repackaging and base pricing.

And as you can imagine, there is some degree of churn that can come from going through that process when you then go back to the dealer. But I think we're pretty confident in the value delivery we're providing. We're pretty pleased with the year-over-year growth number from a top line perspective that we saw in the quarter. So I think we're really happy with where we are.

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

A

And Marvin, I'd add one other thing. We've seen this competitive action before, and I think it's obviously a more desperation on their part. What we usually see is dealers quickly learn that they're dissatisfied with the lack of service and that's one of our value props that we really stand by, which is dealerships we service and support them. So we do not feel the need to lower price. We, in fact, feel the opposite. We feel that our values lower because of the value we provide. And then I also note that mostly in Q1, we focused on cross-selling our customers. So we didn't have the new sales volume to [ph] outlet (00:26:30) lap some of the churn. But yeah, no, we feel good about where we are in the growth that we're seeing in our solutions strategy.

Marvin Fong
Analyst, BTIG LLC

Q

That's terrific. Thanks so much for the color, Alex and Sonia. Appreciate it.

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

A

Thank you, Marvin.

Operator: [Operator Instructions] And our next question comes from Doug Arthur of Huber Research. Your line is open.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Yeah. Good morning. Can you hear me?

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

A

Yeah.

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

A

Yes.

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

A

Hello.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Yeah. Just sticking with Dealer Inspire for a second, Sonia, you kind of ran through the numbers quickly. Did you say that sequentially the dealer count was up 30? Is that what you said?

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

A

I think what we shared is that we were up 630 year-over-year.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC
Q

Okay.

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

So 630 year-over-year.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC
Q

Okay. So the dealer count from the Q4 is up slightly. Is that – I mean, based on looking at the chart, it looks that way?

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

Yeah. It's up about 50 on a sequential basis.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC
Q

Okay.

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

That's website customers.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC
Q

Okay. And there could be multiple customers per dealer. And did you say that revenue growth was 29%?

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

[ph] That's correct (00:27:57).

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC
Q

Okay. And are there any other – I mean, I know you've been onboarding some OEMs from last year. Do you expect more momentum there, more penetration to kind of bulk up the growth as the – I know you referred to the churn, the competitive backdrop, but...

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

Yeah. So I think we have secured the vast majority of all of our OEM endorsements and that was a big step for DI. With that under our belt, the real focus is on continuing now to go to those individual dealerships and win business. And we're pleased, right, with our ability to win what we consider to be our fair share. And I think there's opportunity for us to continue to grow. So I think what I would tell you is, I think the Q1 net adds number is definitely muted relative to what we would expect to be able to deliver for the balance of the year.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. Great. Thank you very much.

Operator: [Operator Instructions] And seeing no further questions, I'll turn the call back over to Alex Vetter, CEO.

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

Thank you. And just before we wrap the call, I want to call a few upcoming IR engagements. On May 10th, Sonia and I will host investor meetings with D.A. Davidson in New York City. On May 18th, we're going to participate in the Barrington Virtual Conference and May 23rd, we're going to participate in a fireside chat in Boston at the JPMorgan Annual Global Technology Media and Communications Conference. So details about these will be available in the events section of our IR website. This concludes our call on May the 4th be with you and thank you very much.

Operator: The meeting has now concluded. Thank you for joining and have a pleasant day.