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Cars.com, Inc. (CARS)

Q3 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Cars.com Third 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.com 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.com third 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 third quarter, then Sonia will discuss our financial highlights 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 financial 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 third quarter 2023 earnings call. I'm pleased to report that we delivered another quarter of solid results at the high-end of our guidance range. I'm also excited to announce our acquisition of D2C Media, a leading automotive technology and digital solutions provider in Canada that enables us to expand our geographical footprint and gain approximately 1,000 new dealer customers.

Before we discuss D2C, let's start with our strong quarterly results. Our third quarter revenue grew 6% year-over-year, driven by growth across our portfolio, including 9% year-over-year ARPD growth. This resulted in adjusted EBITDA margins of 28% and we are well-positioned to build on this growth.

Last month, we launched Cars Commerce, our new go-to-market B2B brand as a natural evolution of our growth strategy. Cars Commerce reinforces our ability to deliver a connected platform that simplifies the pretail, retail and post-sale experiences for shoppers, retailers and OEMs. The mission of Cars Commerce is to simplify everything about buying and selling cars. We aim to eliminate complexity and increase transparency throughout the local retail experience where sales and service are best facilitated.

Our asset-light platform approach, which combines our high-intent audience and industry-leading technology solutions, drives significantly more value and efficiency to dealers and OEMs. Our simplified go-to-market strategy will drive a sustainable growth and adoption of our marketplace, solutions and media products.

Central to our platform is Cars.com, our trademark brand that is the number one most recognized marketplace in the industry, attracting nearly 26 million in-market shoppers each month. This quarter, our traffic increased to 151 million visits, and our organic traffic remains strong at 62%.

The Cars.com audience is highly engaged with more than 84% planning to purchase a vehicle within six months and nearly half within 30 days. Clearly, we have the audience to match buyers and sellers at scale.

Our research consistently shows that approximately 75% of our audience is undecided on make and model, and 90% have not selected a dealership. This is where the consumer pretail journey begins, with visits to Cars.com for unbiased content, ratings and reviews. And we continually improve our marketplace experience to help consumers make more informed decisions. This quarter, we launched My Garage, which allows consumers to add their vehicle to our virtual garage and gain access to new features such as the Cars.com market value.

Cars.com market value connects our marketplace retail data with our real-time trade-in values, helping consumers track the value of their vehicle and know the optimal time to sell or trade in their car. We will continue to add capabilities to My Garage and encourage consumers to register profiles on Cars.com to keep them engaged between vehicle purchases. Not only do we provide consumers with critical information regarding vehicles, we also enhance their experience with dealership insights to help them decide where they'll purchase or trade in their car.

We are a leader in reputation management technology and have the largest reviews platform in the industry with more than 13 million dealer reviews left by car shoppers at quarter end. For many consumers, and especially in the current environment of high interest rates, financing considerations are as important as the vehicle and dealership choice.

The average new vehicle price on our marketplace is up 29% and used car prices increased 40% compared to 2019. Approximately 9,000 dealers have enabled shoppers to get pre-approved using our instant financing solution. Given the significant consumer and customer value, we included instant financing in our 2023 Marketplace Repackaging Initiative, which is now complete and is a significant driver of our 9% year-over-year ARPD growth.

Additionally, I'm pleased to report that our customer count has stabilized and we ended the quarter with 18,715 dealer customers. As part of the Cars Commerce launch, we have consolidated our Media Point Solutions under the Cars Commerce Media Network umbrella. Customers of our marketplace and solutions can access our 26 million monthly in-market shoppers on Cars.com across social, search, display, video and content.

By reaching a highly engaged audience, both local and national automotive advertisers can influence the decision journey, while shoppers are actively determining what, where, when and how to purchase their next vehicle. We know that our retail media solutions drives meaningful business outcomes and solve real audience and measurement challenges that our customers currently face.

For local dealers, we have seen our product suite outperform Google Search advertising by as much as 50% on a lower cost per lead basis. In addition, we see that we're reaching the Cars.com audience across video, display and social channels, also improves dealer website traffic by more than 30% compared to single channel advertising. Bringing together our local media point solutions under Cars Commerce Media Network will allow us to better package our media products for greater retail outcomes.

Cars Commerce Media also works for OEMs. As an example, in the third quarter, one of our OEM partners increased their advertising investment with us for an electric vehicle campaign, which resulted in not only elevated searches and dealer connections on Cars.com, but also on dealer websites that we observed via Dealer Inspire. Specifically, there was a double-digit lift in leads on dealer websites, a clear indication that Cars Commerce Media Network drives retail sales results.

Turning to solutions, which also contributed to our strong revenue growth. Our website solutions are endorsed by nearly every OEM in the United States. Today, we power more than 6,300 dealer websites, up 8%, and we grew website upsells by more than 1,000 compared to the prior year.

Accu-Trade, our trade and appraisal solution, also continues to gain traction, growing to more than 850 units compared to 400 in the prior year and up nearly 100 units on a sequential basis. Accu-Trade creates a much needed used car pipeline for dealers. Dealers using our technology complete appraisals in a fraction of the time that it typically takes, while also increasing accuracy and transparency for the consumer.

By arming everyone in the dealership with accurate turnkey technology, we are improving both dealership profitability and the consumer experience online and in the store. For the quarter, dealers conducted more than 500,000 appraisals in nearly 20% sequential increase. Our solutions momentum continues. We are excited about our acquisition of D2C Media, a leading automotive technology and digital solutions provider in Canada. It affords us the opportunity to further expand our Cars Commerce platform into the Canadian market and demonstrates our continued commitment to empowering dealers with innovative digital solutions.

D2C Media has approximately 1,000 customers today, and together, we have website endorsements covering approximately 60% of OEMs operating in Canada, positioning us to unlock additional growth opportunities. D2C has demonstrated strong financial performance, consistently generating double-digit top line growth and strong adjusted EBITDA margins. This acquisition will allow us to accelerate the growth of both websites and our digital solutions into Canada.

Before I turn the call over to Sonia, I want to recognize our team of innovators, creators and problem solvers who work every day to swiftly tailor our products and simplify everything about car buying and selling. Together, we posted another quarter of solid results, launched Cars Commerce, grew dealer revenue, turned the corner on OEM sales and expanded our growth opportunities with the acquisition of D2C Media.

I am also honored to share that we were recognized as one of U.S. News & World Report Best Companies to Work For in 2024. And on behalf of all of our employees, we are excited to welcome the newest D2C employees to the Cars Commerce team, where together we will continue to drive our platform strategy.

Now, I'd like to turn over the call to Sonia to provide additional details on the quarter. Sonia?

Sonia Jain

Chief Financial Officer, Cars.com, Inc.

Thank you, Alex. I too am pleased with our strong performance. We delivered accelerated year-over-year revenue growth and sequential improvement in margin at and above the high-end of our guidance. I'm also excited about our acquisition of D2C Media, which we expect will be immediately accretive to our top line growth rate and adjusted EBITDA margin.

But first, let's start with our quarterly results. Revenue for the quarter totaled $174 million, a 6% increase compared to the prior year, driven by dealer revenue that grew 8% year-over-year to $157 million. OEM and National revenue was $15 million, 2% lower compared to the prior year. However, looking specifically at our OEM advertising customers, revenue increased 12% year-over-year and sequentially, OEM and National revenue grew $2.1 million.

Additionally, other revenue was down approximately $2 million year-over-year, primarily due to the planned expiration of a non-cash Accu-Trade license agreement with a former owner that expired earlier this year.

Moving to our expenses. We continue to exercise disciplined expense management while investing to support our revenue growth. Adjusted operating expenses were $151 million, $14 million higher than a year ago, primarily due to higher investment in marketing, specifically Brand Media to support the Cars.com Possibilities advertising campaign, in-person employee events and compensation expense.

Our brand investments are critical to our organic traffic strength and ensure that Cars.com remains top of mind for both consumers and dealers. The fact that over 60% of our traffic comes to us organically drives long-term marketing and financial efficiency for our business. And it also allows us to deliver a unique, high intent audience to our customers that cannot be duplicated through traditional paid advertising channels.

Product and technology investment increased $3 million year-over-year as we continue to invest in consumer and customer experiences. Alex referenced My Garage and Cars.com market value, new features launched this quarter that drive consumer engagement on marketplace, enhancing our organic traffic strength and dealer value delivery.

Net income for the quarter totaled $4.5 million, or $0.07 per diluted share, compared to a net loss of $0.04 per diluted share a year ago. The change in net income is primarily attributable to the change in the fair value of contingent consideration associated with the company's prior acquisitions. For the quarter, we delivered adjusted

EBITDA of $49 million or 28.4% of revenue at the high-end of our guidance range. Sequentially, our margin expanded 125 basis points.

As Alex mentioned, this quarter, we completed our 2023 Marketplace Repackaging initiative. Results have been positive with over 80% of our 9% year-over-year growth in ARPD, driven by a combination of repricing and upgrades. To that point, nearly 70% of repackaged customers upgraded to either the value-added preferred or premium package. These higher tier packages include more of our platform advantages and, as a result, provide dealers with greater value. As an example, upgrading to the preferred or premium package has a double-digit improvement on inventory turn times for dealers.

With 2023 Repackaging behind us, our customer base is stabilizing and we ended the quarter with 18,7`15 customers. Independent of Repackaging, our Q3 retention rate remained near historic highs. Continued demand for our solutions, both websites and Accu-Trade also bolstered our ARPD growth for the quarter. Website customers continue to grow. As of quarter end, we powered more than 6,300 websites, up over 400 from a year ago and up over 150 sequentially. We remain focused on value delivery to our customers and the size and scale of our audience is an important component of that equation. For the quarter, total traffic increased to 151 million visits and monthly unique visitors totaled 26 million.

We continue to make strategic moves that expand and advance our platform strategy. Yesterday, we acquired D2C Media, a leading Canadian provider of website and digital advertising solutions that extends our reach into new markets with our already strong solutions portfolio. D2C Media has approximately 1,000 dealer customers, a strong in-market team with tenured experience in the Canadian market, and importantly, a business that has consistently delivered double-digit revenue growth and high adjusted EBITDA margins.

We're excited about D2C's potential to help us accelerate our profitable top line growth. Not only do we have the ability to grow our website footprint with our combined OEM endorsements, but we also see additional opportunity for growth through integration and cross-sell of our digital retailing tools and Accu-Trade to Canadian customers.

Now turning to our balance sheet. Our strong cash flow and liquidity position gives us the financial flexibility to invest in growth opportunities like D2C. Cash provided by operating activities for the nine-month period ended September 30, 2023, totaled $92 million and free cash flow was $76 million, compared to $77 million a year ago. Cash flow was strong year-over-year, despite the $16 million year-over-year increase in cash taxes, the majority of which was offset by favorable changes in working capital.

During the first nine months of the year, we paid down $26 million of debt, reducing our total debt outstanding to $455 million as of September 30, 2023. And year-to-date, we also repurchased 1.3 million shares for $24 million. And we continue to see value in share repurchases.

At quarter end, our net leverage ratio was 2.1 times, at the low end of our target range of 2 to 2.5 times. We continue to maintain ample liquidity of $279 million, comprised of $49 million in cash on hand and $230 million of undrawn revolver. Yesterday, we funded the D2C Media acquisition with a combination of cash on hand and revolver draw. Pro forma for the acquisition, our net leverage ratio as of September 30 would have been 2.5 times, at the high end, but still within our target range.

I also want to reaffirm our commitment to our balanced capital allocation strategy. Given our strong free cash flow generation, we remain committed to paying down debt and continuing to repurchase shares.

Now for our fourth quarter guidance, we expect to deliver revenue of approximately $177 million to $179 million, representing year-over-year growth of 5.2% to 6.4%. Our guidance reflects continued growth in dealer revenue, driven by continued adoption of dealer solutions and media products, as well as modest sequential improvement in OEM and National revenue.

In addition, our fourth quarter guidance includes two months of revenue associated with our acquisition of D2C Media, which we expect will contribute approximately 1.5% of our total revenue dollars in the fourth quarter. Recall that sequentially the fourth quarter is often impacted by seasonal trends, and our year-over-year growth rate reflects both the successful launch of Accu-Trade Connected and the favorable renegotiation of key website agreements from the fourth quarter of last year.

For the full year, our fourth quarter guidance, along with performance to-date, places us comfortably within our previously shared revenue guidance range of 4% to 6%. Full year performance reflects the benefit of this year's Marketplace Repackaging initiative, continued penetration of our dealer solutions, and modest improvement in OEM revenue, offset by a challenging environment for auto adjacent advertisers, including insurance company.

We expect fourth quarter adjusted EBITDA margin of 29.5% to 30.5% in line with our previous guidance of approaching 30%. Our consistent and reliable growth demonstrates that our asset-light platform strategy with connected technology solution generates strong diversified revenue streams for our business. This, along with our focused execution, positioned us well to further drive sustainable, profitable growth.

And with that, I'd like to open the call for Q&A. Operator?

QUESTION AND ANSWER SECTION

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

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

Q

Great. Good morning. Thanks, and nice quarter, guys. A question on OEM ad spend. It sounds like it's perking up a bit. It's clearly – it's been a few years since new vehicle production levels and inventories were kind of sufficient enough to have these OEMs really need to support their franchise dealers with much spend. And in that time, I'd imagine that the types of digital advertising technologies and product offerings that are available to OEMs and getting pitch to OEMs have evolved and changed quite a bit.

I'm curious if you'd say that that was true and how can you guys ensure that Cars.com can recapture kind of its fair share of this OEM digital ad revenue as it recovers in the coming quarters? Like, do you think you've got the right products? Do you need to change or add kind of new offerings to capture that OEM kind of ad spend recovery?

And then just a quick follow-up on dealer count. It sounds like it's stabilized here and the repackaging is done. Just curious if you're seeing any kind of boomerang customers that maybe churned earlier in this year kind of coming back now that it looks like inventories on dealer lots are – have been building a bit. Thanks.

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

Tom, thanks for your comments on the quarter. We, too, are pleased. And to start on your question regarding OEM. Products are always going to change and evolve, but I think our core reason to believe is more about audience. We're capturing organically the highest concentration of active in-market shoppers that are actively comparing makes and models and deciding what and where to buy in real-time. And if you look at OEM spending over the last, call it, 10 years, it's been obsessed with legacy digital KPIs around frequency clicks, impressions. And we see the market moving much closer towards retail outcomes.

And that as OEMs need to rethink their business models and become more efficient, they're going to need to spend less money but maximize sales output. And we see clearly through our data that when OEMs invest in Cars.com, it drives dealer retail results. And so, yes, we'll tweak our product mix and we'll offer new solutions that uses technology to its advantage. But ultimately, the value prop is access to a high intention audience.

I think on the marketplace side, we are seeing boomerang dealers that have come back. I think that anytime you raise rates in mass on your customer base, you're going to lose a percentage of that market. But the value we were delivering more than justifies the price points that we were asking. And so, we are seeing dealers come back to us, particularly now that demand is cooling and inventory levels are rising. Dealers are looking to figure out how they're going to be able to move their inventory at a faster rate.

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

Great. Thanks very much.

Operator: Thank you. And our next question comes from Rajat Gupta from JPMorgan. Your line is open.

Rajat Gupta
Analyst, JPMorgan Securities LLC
Q

Great. Thanks for taking the questions. I just had a question on the broader growth algorithm for the company. Outside of the D2C acquisition and with some of the Repackaging initiatives now behind you, what should investors be banking on as the key source of a growth into 2024 and beyond? Is it the cross-sell of the new products or is it a rebound in dealer count, OEM, National revenue? I mean, any one or two areas that you would stress on that would be the key drivers of growth going forward. Just a broader question, and I'm going to have like a more model follow-up. Thanks.

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

Sure, Rajat. Thanks for the question. I think what's exciting about the business is that we're sitting at a point in time or where our growth vectors are very diversified and many. I think let's start with just dealer count. We've got less than 20,000 dealers and a domestic TAM of 40,000. And then even with the addition of D2C Media in Canada, we've got a now a 1,000 dealers in Canada with a TAM of close to 10,000 dealers that we can go after there as well. Importantly, even though we repackaged and repriced this year, that doesn't mean that there is an additional opportunities to keep doing that in future years.

And certainly, we think OEM, obviously a bounced in the quarter which is exciting to see. We've asked for investor patience as we retool that business and we got a nice bounce in it in third quarter and we see tremendous upside in OEM spending over next year as well. I think the big area of untapped opportunity is now bringing our digital solutions to the OEMs as well. 50% of new vehicle sales have a trade-in, yet most OEMs do not have a trade-in solution for their customers as they want to offer on their Tier-1 websites. And we see continued adoption from OEMs wanting to outfit their dealer networks with tech. So we've got a lot of opportunity for growth, whether it's product, pricing, packaging, but certainly the market share alone is a reason to believe. Sonia, I don't know what else you'd add.

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

A

No, I think you covered it really well. I think dealer customer growth continues to be a vector for us. And then I think importantly for Marketplace Repackaging this year was kind of a two-pronged initiative. We did take price, obviously, which you've seen reflected in our ARPD, but we also put in place a packaging structure that we can leverage going forward as we think about how to advance more of the platform value in a bundled context and platform context, as opposed to point solutions which are a little harder to increment quickly.

Rajat Gupta
Analyst, JPMorgan Securities LLC

Q

Got it. Just to follow up on Alex comments on the OEM revenue now stabilizing and big opportunity. Is there any way to like size that, how you anticipate that progressing beyond the third quarter? You gave some guidance for the fourth quarter that will be sequentially up. But like how should we think about that run rate into next year? And just relatedly, presumably, that has higher incremental drop-through to the bottom line versus the dealer business. Can you just add more color on that, it would be helpful?

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

A

Yes, certainly, the OEM revenues are some of the highest margin revenues that the business enjoys. And it's been on a multi-year slide with the inventory shortages. And now that inventory levels are blossoming again. There is an opportunity for us to expand this line of the business, which has positive top line and bottom line implications. I think that said, OEM revenues tend to be very choppy, unlike our highly reoccurring sticky dealer subscription business, which you can reliably predict from quarter-to-quarter.

The OEM revenue comes in lumps and seasonal needs for urgency by the OEMs to ramp up something in a period. And so, it is a little bit harder to predict without the reoccurrence of that revenue. But we definitely see big upside in OEM spending close to $20 billion being spent domestically by OEMs in advertising, yet 90% of those dollars are going to people that aren't in the market to buy a car. And so, we see tremendous upside in our go-to-market, which is part of why we've rebranded as Cars.com Commerce Media, so that OEMs know that we can actually help them facilitate transactions at the retail level.

Rajat Gupta
Analyst, JPMorgan Securities LLC

Q

Got it.

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

A

And I think we'll be in a good position to share more detail, right, when we give our 2024 guidance in a couple of months around how to think about the shape of OEM revenue evolving. But I do think, and I think you probably got our takeaway is we were really pleased to see kind of that sequential improvement and turning the corner a little bit, so to speak, on OEM performance and there the attractiveness they see in our audience.

Rajat Gupta
Analyst, JPMorgan Securities LLC

Q

Understood. Great. Thanks for all the color. I'll jump back in queue.

Operator: And we have a question from Naved Khan from B. Riley Securities. Your line is open.

Naved Khan
Analyst, B. Riley Securities, Inc.

Q

Yeah. Hi. Thank you, and congrats on the results. I had a couple of questions. So in your Q4 outlook, I think you guys expect – you guys say that you expect OEM to be up sequentially. And I'm wondering if you are running any campaigns that gives you that level of visibility or is it more of a broad-based trend that's kind of helping this line?

And the other question I had is just on the D2C Media. Just, Alex, maybe can you talk about the levers you have to kind of drive the business up from here ? You said it was a double-digit grower on its own. Just give us some thoughts on what you can do to kind of take it to the next level.

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

A

I think maybe just really briefly on the OEM question. Given that we are part of the way through the quarter, a lot of OEMs book with us in advance. So we have upfronts that we do with them at the beginning of every year and then we have incremental sales on top of that. And so at this point in the quarter, we have pretty solid visibility into our expectation, which is informing our guidance around OEM and National revenue.

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

A

Correct. And then on D2C, a couple of answers there. First and foremost, D2C only has 1,000 dealers out of a TAM of over 10,000 in Canada alone. So there's organic upside to grow just the share of dealers using the D2C platform in Canada. But importantly, if you look at the OEM endorsements currently as DI, we only had six OEM endorsements in Canada where D2C has 12. There is some duplication, but the net effect is that we have 15 OEMs where we have a license to hunt in the Canadian market.

And so, it opens up the sales aperture for that team to expand in Canada even faster than they currently are. It reminds me a lot of DI and what it looked like there where we ran that playbook here in the US market. So I consider this to be a similar play that we've run and executed before. I think the final one is that, Accu-Trade continues to build momentum. We are adding features, we're improving the onboarding, we're seeing higher dealer utilization and the value there is overwhelming.

We want to distribute this technology throughout Canada and the D2C Media team being locally entrenched with strong relationships to an established dealer base certainly gives us a distribution path for Accu-Trade in Canada. I think further on, obviously, there is an aspiration to launch our marketplace in Canada, but that will come once we've built up the supply side of our business in the country.

Naved Khan
Analyst, B. Riley Securities, Inc.

Q

Understood. And in terms of just the product, Alex, you will have Dealer Inspire product and now you have the D2C. Is there somebody down the line? Is there scope for consolidating that, or do you see one better than the other and kind of just moving every customer to that? Is that something we can expect or is that not necessarily the case?

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

A

There is a plan to align roadmaps and leverage more synergy between the two platforms, but we are consolidating both brands under the Cars Commerce umbrella so that we can work directly with OEMs for inclusion in their preferred programs and then provide robust reporting, analytics and support, that's North American in nature. And so that strengthens our OEM relationships and our ability to serve and support their needs, because most of them are looking for solutions that cover both geographies.

Naved Khan
Analyst, B. Riley Securities, Inc.

Q

Understood. Great. Thank you, guys.

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

A

Thank you.

Operator: [Operator Instructions] And our next question comes from Gary Prestopino from Barrington Research. Thank you. Your line is open.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Hey, thanks. Good morning, everyone. A couple of questions here. First of all, Alex, you said Accu-Trade appraisals were up 20% to 500,000. Is that a year-over-year number or was that sequentially?

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

A

Sequential.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. In terms of car sales through Accu-Trade. Can you give us some idea of as a percentage of appraisals, how many are actually picked off by the dealers?

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

A

I don't have that data handy, Gary, but we have visibility on that. And what's important is that we can see if the dealer that the car was originally sent to, bought the car or if it appears in another one of our dealer partners, because through our back-end technology, we can do VIN matching to see which dealer bought the car. And I will tell you that the vast majority of vehicles are being bought by the dealer network. Sometimes it's not the initial dealer, but the cars are absolutely being acquired by our network.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay, that's great. So then shifting to D2C Media, you said 1,000 dealers out of 10K in Canada. Are most of their dealer base franchise or independents?

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

A

Yeah, about 80% of their dealer network is franchised and about 20% independent.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. All right. And then it's pretty easy to see what you can cross-sell up into Canada, but is there anything that D2C brings to you that you can – in terms of their products that you can cross-sell into the US market?

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

A

You know, they do have some great technology, both a CRM platform as well as a BDC tool that helps do appointment setting on behalf of dealers. Gary, we have a lot of dealers that have personnel that turns over in the US and so we have churn in our marketplace subscriptions and they've built a solution that helps dealers preserve volume from their websites by leveraging a call center approach that we think has really enabled them to build a highly sticky solution for dealers.

And I could see applicability of that here in the US over the next, call it, 12 months will be consolidating our roadmaps and aligning so that we can build tech once and distribute it multiple times. And that's really the benefit of our asset-light software model is that we can get that operating synergy through the technology.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

What about their advanced inventory management? What is that all about that products?

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

A

Well, they've done some great work there, but as have we and we look forward to sharing more news about some of our inventory management capabilities going into next year. But obviously, as you can imagine, we're syndicating inventory within our platform across multiple solutions and powering dealer websites in the marketplace.

And so dealers have consistently said to us, if you could add an inventory management capability that allows me to syndicate my inventory out to other third-parties, it would allow me to enter more of my relationship with Cars Commerce, and so stay tuned on that front. We've got a lot of work underway and it's an area of opportunity for us, for sure.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

And then just to be clear, this is not dilutive to your adjusted EBITDA margin. Correct?

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

A

No,

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

A

No.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Thank you.

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

A

Thank you, Gary.

Operator: We have a question from Kunal Madhukar from UBS. Your line is open.

Kunal Madhukar
Analyst, UBS Securities LLC

Q

Thanks for taking the question. Couple, if I could, one on the Canadian market. Can you talk about the competitive landscape that you are facing and what gives you the confidence that you can drive growth in a market that is probably similar to the US in terms of maturity? And then on the overall dealer count as a whole, how should we think of the growth given that dealer count was declining even prior to COVID. And so what should drive the growth in the US once we have troughed, whenever this year, next year, whenever we trough what drives the growth? Thank you.

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

A

Sure, Kunal. Thanks for the question. I think your first question was about the competitive landscape in Canada. And I would tell you it is very analogous to what we saw with Dealer Inspire here in the US. A handful of providers without scale or infrastructure to really generate that scale and needing an investment to expand.

And so the D2C platform is fantastic. The best part of that asset are the people that are locally ensconced in their communities and have strong dealer relations and are looking for more product to sell. And so we're excited to partner and distribute our technology like Accu-Trade throughout the region where we've had steady inbound demand from Canadian dealers, but not a real fulfillment capability to serve the market in real-time. And so we've now rapidly built in distribution throughout the country.

I think on the dealer count side, look, yes, we've been in on the dealer slide prior to COVID. But you also have to remember, and we documented a chart in our earnings that shows that dealer count. If you look at where some of that dealer growth or dealer loss came from was within the fall of digital dealers. It largely scaled up over the last few years as companies like Vroom, Carvana, Shift, [ph] Tread (00:40:50), CarLotz expanded virtual dealerships. And those businesses have a lot bigger challenges that that resulted in a pullback of close to 700 dealerships falling out of our dealer count.

I think the key to growing dealer count is provide incredible value, which we have through our organic traffic value delivery, our website solutions and our technologies and tools. But what's also important is having a robust service and support network that meets them where they are. And so we were established in the market and we see great opportunity to continue to grow dealer sales.

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

A

But I just want to maybe add a couple more thoughts to that, which is we did experience dealer losses during COVID, but post COVID essentially post, kind of, Q2 of 2020, we were on a very steady progression upwards in terms of dealer customer additions. And I would attribute it to a couple of different things.

I think our investments in the business to improve traffic, the quality of our SEO, the strength of our organic audience, expansion of our product suite on the solution side, which is another sort of avenue by which dealers can get to know our marketplace. I think that, that's important to know, we have seen a little bit of pressure in the last several quarters on the dealer customer numbers, which, as Alex mentioned, is very much attributable to some of the challenges certain digital dealers were experiencing over, call it, the last year, which then resulted in them pulling back advertising spend when their business models were going through those challenges.

But we were on a very steady clip of dealer customer growth and actually dealer customer growth even prior to COVID. So that trend has been there. It's just a little bit more under pressure over the last couple of quarters with digital dealer, and then our decision, frankly, to go ahead with marketplace repackaging, which we view as really key to driving future growth in the business. A, because it gives our customers broader access to our platform, which improves their performance. We've seen it in inventory turn times, we've seen it in ad efficiency and drive value in the future. So I just wanted to provide that additional color.

Operator: [Operator Instructions] And our next question is from Marvin Fong from BTIG.

Marvin Fong
Analyst, BTIG LLC

Q

Great. Thanks for taking my questions. Congratulations on the quarter. Just a broader question, I guess, I think as you're active in M&A, again, just I know that you are now back up to sort of the upper end of your leverage ratio, but could you just kind of talk about your appetite for additional M&A or was this more like a one-off opportunistic acquisition? And then I have a follow-up.

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

A

Yeah, no, I mean, I think we believe D2C is a really attractive way for us to expand our geography and also sort of extend the reach of our solutions. I think we continue to be open minded around M&A as an opportunity to accelerate our growth either geographically or as you've seen in other cases where it's helped us really leapfrog our product portfolio and product development.

So it'll continue to be interesting. But we have been very committed to maintaining and operating within our target leverage range. I think the great news for us as a business is just given the cash flow profile of the business, we can do a little bit of everything. So we can, in fact, go out and do deals like this that are really accretive to our portfolio. And we do believe we'll be able to sort of swiftly pay down debt while continuing to be out there in the market from a share repurchase perspective.

Marvin Fong
Analyst, BTIG LLC

Q

Great. Thanks, Sonia. And maybe just a two-part question on D2C operationally. So just so I understand basically because of the way the OEM endorsements work like these, D2C and Dealer Inspire basically have to operate separately and Dealer Inspire can like go into D2C's endorsements right? And just wanted to clarify how the two of them are, kind of, operate side-by-side until you can, kind of, integrate the roadmaps. And then the second part of the question, just like, how – what's sort of the visibility in terms of sort of like getting that 50% of endorsements higher like or approval windows by the OEMs opening up in the next year or so? Or how do you plan on getting that 60% up? Thanks.

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

A

Great, question, Marvin. Thank you. So the way the OEM dealer business works for websites is that in Canada, as in the US, you need to be certified as a preferred provider in order to bring a franchise dealer on board. Certainly, any independent operator, which again, D2C Media has got over 200 independent dealers in their current customer count.

So I'm speaking only to franchise, but you need that OEM endorsement and D2C has been building that up in Canada to 12 endorsements but they didn't have some of the key ones that Dealer Inspire currently has in Canada. We only have had six in Canada, because it hasn't been a primary focus for us. Now, the team locally can sell significantly more dealers in Canada than before because they [ph] can (00:47:08) sell DI Solution now that they're part of the Cars Commerce family.

And so we immediately open up D2C Media's TAM just by the sheer fact that they can sell on program dealers for OEMs that they currently didn't have. I think over time we're going to consolidate our efforts under Cars Commerce, negotiate to get preferred relationships with all OEMs like we successfully have done in the US. We know that those relationships are easily brokered into in a Canadian expansion. And so we feel very confident working with our OEM partners that will rapidly expand the number of OEMs that we're eligible for. Because what they're really looking for is capability. And we have shown that we have the capabilities to meet all of their technical product and operational needs. And so it'll take us a little time. But I hope by this time next year, we're at a much healthier mix of full OEM inclusion and no limitations to our distribution in Canada.

Marvin Fong
Analyst, BTIG LLC

Q

Perfect. That's very helpful. Thanks so much, Alex.

Operator: Thank you. I'm seeing no further questions, I'll turn the call back over to our host Robbin Moore-Randolph for final comments.

Robbin Moore-Randolph

Director-Investor Relations, Cars.com, Inc.

Thank you all for your questions. We continue to share our story and we look forward to seeing many of you as part of our upcoming IR engagements. On November 15, we'll participate in RBC Capital's Conference in New York; November 16, we'll participate in D.A. Davidson Technology Summit also in New York; and on November 20, we'll participate in Needham's Consumer Tech/E-commerce Virtual Conference. Details about these events are available on the events section of our IR website.

This concludes our call and thank you for your time today.

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