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Cars.com, Inc. (CARS)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Cars.com Fourth Quarter 2020 Earnings Conference Call. Hosting the call this morning is Alex Vetter, Chief Executive Officer; and Sonia Jain, 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 March 11th. 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 Jandy Tomy, Treasurer.

Jandy Tomy
Treasurer, Cars.com, Inc.

Good morning, everyone and welcome to our fourth quarter and full year 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 with our earnings press release and in the appendix of the presentation. For more information, please refer to the risk factors included in our SEC filings including those in our Annual, Quarterly, and Current reports. 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.

T. Alex Vetter

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

Good morning everyone and welcome to our conference call for the fourth quarter and full year of 2020. On today's call I'll be discussing business highlights from our year and fourth quarter and provide an overview of the expectations and priorities for 2021. I'll then hand the call over to Sonia who will discuss our financial results in greater detail.

CARS delivered impressive results in 2020 despite the pandemic we grew ARPD for the second consecutive quarter and grew dealer customers in three out of four quarters this past year all while reaching record levels of traffic and lead generation. Our performance resulted in a return to year-over-year revenue growth in the fourth quarter.

In 2020 our team also maintains strict spending discipline and continued to invest strategically in the business, driving incredibly strong quarterly and annual adjusted EBITDA and cash flow. In a subscription business like ours, it's important to remember how impactful a strong year-end exit rate is and how well it positions us as we enter 2021.

The accelerated adoption of digital products and solutions by our dealer customers has been core to our success. Until 2020, many dealers were reluctant to fully embrace a digital-first strategy. The pandemic accelerated car dealers' adoption of digital tools and we have seen a marked increase in dealers subscribing to our digital solutions. And we expect the trend that emerged from the stay-at-home economy to endure.

Despite signs that the stay-at-home requirements are subsiding, the preference for cars is a mode of transportation and car ownership persists. And consumers are appreciating the convenience of shopping when, where and how they want. Not only are dealers embracing technology to meet the changing expectations of car shoppers but they are also finding meaningful efficiencies in their businesses. Today the showroom is both physical and digital. The range of car solutions are perfect to satisfy traditional showroom sales and also equip dealers to meet the demand for digital retail as a strategic imperative.

Marketplaces like Cars.com are and will continue to be vital to the success of dealers because we are a valuable platform for attracting in-market shoppers and sales at scale. During the severe restrictions over the past year consumers flocked to our platform to research, shop and connect with local dealers online. We responded by creating tools for dealers to more effectively showcase their services and available inventory. Our home delivery and online shopping badges, which identify the dealers who offer these services have seen incredible adoption since they were launched. In fact we have badged nearly 20 million vehicles to date. We also saw a material increase in the number of customers leveraging our CARS social and FUEL products as dealers seek to connect with our targeted in-market car shopping audience.

The Cars.com Marketplace has a unique advantage in its ability to efficiently drive high quality in-market traffic. Today we generate over two-thirds of our traffic from organic sources, which allow us to balance and control our marketing spend while providing unique audience to our clients. Cars.com attracts a high volume of quality direct traffic driven by the industry's number one brand, most popular mobile app, credible editorial content, ratings and reviews.

Our industry-leading editorial content is an important sustainable advantage and differentiator for our consumer experience and another lever supporting our organic traffic. For example, this month we've been announcing our annual Best Of awards, which reveal the best cars in five categories. This unique content initiative continues to win favor from consumers and drive new visitors to the site.

The industry also recognizes our authority, even showcasing our awards in their own advertising and press. Just in the last two weeks both Volkswagen and Hyundai issued press releases publicizing the Best Family Vehicle and the Best Value Vehicle awards they received from our editorial staff, a demonstration of how impactful it is to earn credible third party validation for their vehicles.

In 2020 organic traffic grew 10% and mobile traffic grew 12% year-over-year, demonstrating the increasing strength of our brand and the shift towards online car shopping. Our organic traffic coupled with a surge in online activity and a more favorable SEM pricing environment led to our ability to reduce our year-over-year marketing investments while still achieving growth. Despite materially reduced investment particularly in the second and third quarters, Cars.com posted record traffic and lead numbers in 2020. Traffic and unique visitors were up 8% and 5% year-over-year respectively, and leads were up 13% year-over-year. While traffic is an important measure of performance, we are ultimately focused on delivering high quality connections to our dealers in an effort to maximize their ROI, traffic and leads that are more likely to translate into sales.

Another metric that has been increasing in importance is website referral traffic, which represents the consumers who start shopping on a marketplace like Cars.com and then click through to the dealers' website. Dealers consistently cite leads from their own website as converting at the highest level. Data from thousands of website customers last year showed that Cars.com sent three times more ready-to-buy car shoppers to dealer websites compared to its nearest third-party Marketplace competitors. In addition, these Cars.com shoppers purchased cars from those dealers at twice the rate of those who solely visit a dealer website.

As dealers are increasingly focused on digital metrics the strength of our referral traffic helps demonstrate our platform strength and quality attribution, leading to our record retention rates. Unlike our competition we don't need to spend nearly as much in traffic acquisition because our brand and original content drives the vast majority of our traffic. In 2020 73% of our traffic was generated by organic channels. With our value building and the strength of our year-to-date traffic and leads, in the fourth quarter, we prioritize longer-term investments into our brand to continue to ensure its number one position and long-term health. Those investments coupled with the strength of our audience and value delivery to our dealers is reflected in the strong retention rates and growth in our dealer customers in the second half of this year.

We grew our dealer customers by over 300 dealers in the second half of 2020, and nearly half of this growth was from Marketplace. We are experiencing record high customer retention rates, and that momentum continues into the first quarter of 2021. Our differentiated digital solutions strategy played a key role in facilitating auto sales for our customers, as dealers embraced online selling and virtual tools to engage with consumers. Our tools allowed dealers to compete virtually and supported increased and more efficient sales. Dealers have been able to continue to leverage some of these operational efficiencies even if restrictions eased, enabling them to reach new levels of profitability.

Dealers leverage our digital solutions to have more touch points with consumers in their car-buying experience. Today we power 4,400 dealer websites, having added 1200 new website customers in 2020. Online shopper and Conversations penetration rates also have grown from 14% and 25% last year to 20 and 27% at the end of 2020. Keep in mind these penetration rates are on top of a growing base of website customers. We expect to see growth as we continue to deliver on other business in our pipeline as well as complete the initial launch of the GM website in 2021.

We also see an opportunity to help to dealers to leverage digital advertising to sell more cars. In the fourth quarter we announced that FordDirect selected Dealer Inspire as a preferred digital advertising provider for its US Ford dealerships. These dealers now have access to Dealer Inspire's full suite of connected digital marketing services via our proprietary ad tech platform and advanced reporting technology PRIZM.

FUEL is another market driving solution for dealers that is gaining credible traction since we first announced the launch of this product just one year ago. It continues to be the fastest growing new product in CARS' history. FUEL is a unique high-ROI targeted video advertising solution that generates higher returns than expensive dated and wasteful traditional TV model, on which the auto industry spends approximately $10 billion a year. Because such a small fraction of the US population is actively shopping for a car at any given time, FUEL empowers dealerships to reach and advertise purely to in-market car shoppers by leveraging the power of Car.com's unique in-market audience.

FUEL customers seek twice the average click-through rate compared to industry averages and our dealers are seeing benefits of how efficiently FUEL targets in-market car shoppers.

In fact one of our FUEL customers, the GM of regional Hyundai in Broken Arrow, Oklahoma, recently said "If I was told I had to cancel every marketing tool I had and only keep one, FUEL would be it." After just one year FUEL has been adopted by the most aggressive dealers in the country. And there's a lot more opportunity for further penetration into the zip codes within each market on an exclusive geographic basis. FUEL is ARPD-accretive and only available to existing Marketplace customers.

Now, turning to the automotive environment. In terms of used cars prices remain high and strong demand on leading new car inventory is strengthening dealer margins. Retail sales continue to show strength in both new and used car markets. December SAAR was 16.3 million and the fourth best December for sales. OEM incentives were down over 8% in December and more than 7% for the quarter further demonstrating the strength of the market driven by consumer demand and tight inventory.

Turning to our national business, while revenue was down 9% on a year-over-year basis we have seen consecutive quarters of revenue improvement in the second half of 2020. Fourth quarter revenue surpassed our first quarter revenue and we are pleased to see signs of stabilization after weathering the challenges of COVID-19.

In addition, we have seen continued traction and interest among auto adjacent customers as well as with the Tier 2 associations that are looking to access in-market car shoppers. These continue to be promising opportunities for us and help further diversify our revenue.

Over the last few quarters we had more overtly discussed our company's DEI actions and our efforts to drive representation in the auto industry. Of all of the franchise dealers in the United States, just over 1,200 are minority-owned and 265 are black-owned. In the fourth quarter we partnered with Facebook to conduct a trial leveraging our social selling solutions for more than 200 members of the National Association of Minority Automobile Dealers, NAMAD. We also had held digital advertising selling and education sessions to provide them with the information and technology to better compete.

CARS is also a longtime supporter of the Women in Automotive Organization. Just 18% of auto dealers are women and women of color represent only 6% of the industry workforce. We are proud to have one of the most diverse executive teams and companies in our industry with 46% of CARS employees identifying as female and 23% identifying as racial or ethnically diverse. And while this significantly outpaces the industry we know we can and we will do more.

In 2021 we will continue to focus on DEI, reflecting the important role these actions play in maintaining CARS' strong corporate culture and ensuring we retain the industry's best and brightest talent. Additionally, each of our executive team members' compensation will now be linked to DEI. We will also continue to build stronger policies and provide more public disclosures of our company's progress on DEI and other social and environmental factors most directly related to our industry and our business.

Entering 2021 we have an improved competitive position. We have deep and high value relationships with our dealers, a compelling product portfolio, a massive in-market audience driven by our brand, and a very strong financial position as a result of the actions we took during 2020. Despite the challenges we faced last year, we delivered year-over-year revenue growth in the fourth quarter, strong adjusted EBITDA and cash flow, and we have a capital structure that gives us flexibility to invest in the business and pursue inorganic growth.

We've grown dealer customers in both January and February, giving us strong momentum for the first quarter of this year. Our strategy remains focused on empowering consumers with unique content, data and information they need to make informed car buying decisions and supporting our customers with efficient digital solutions that drive high quality consumer audiences and increased sales conversion, further cementing our unique value and differentiation in the market.

At this time, I'd like to turn the call over to Sonia to discuss our financial results for the fourth quarter and full year 2020 and additional details around our 2021 outlook, assumptions and key drivers. Sonia?

Sonia Jain

Chief Financial Officer, Cars.com, Inc.

Thank you, Alex. We delivered solid results this quarter. We grew top line revenue, generated strong cash flow and profitability and ended the year with $68 million in cash and cash equivalents. First, let me discuss the quarter. Revenue was $153 million, up 1% year-over-year. Higher ARPD, driven by solutions sales drove this top line growth. Year-over-year, Dealer Inspire revenues grew 22%. National advertising revenue in the fourth quarter was the highest of the year at $20 million, down just $1 million or 5% year-over-year.

Turning to expenses, total operating expenses for the fourth quarter were $137.1 million compared to $147.5 million for the prior year period. Expenses were down primarily due to the elimination of our affiliate revenue share expense in the second quarter of 2020. This will continue to benefit our year-over-year metrics in the first half of 2021. We also thoughtfully reinvested in the business in both the third and fourth quarters last year. Marketing spend in particular was up year-over-year as we reinvested in our brand.

GAAP net income for the fourth quarter of 2020 was $7.2 million or $0.10 per share, up from a GAAP net loss -- up from a GAAP net loss of $4.1 million or $0.06 per diluted share in the prior year. This was driven by tax benefits generated through an increase in the company's ability to carry back operating losses as a result of the CARES Act. Adjusted net income for the fourth quarter of 2020 was $6 million compared to $42.2 million in the fourth quarter of 2019. This decline is due to adjustments to our annual effective tax rate, which had a significant impact on the quarter's effective tax rate. Fourth quarter adjusted EBITDA was $48.5 million or 32% of revenue compared to $39.3 million or 26% of revenue for the prior year period.

Before I move on to an overview of full year 2020 results, I'd like to take a moment to review the key operating metrics that underlie these very solid quarterly results. We have 18,372 dealer customers as of December 31, 2020, an increase of 1% compared to 18,130 as of September 30, 2020. This increase is primarily due to continuing strong retention rates coupled with the solid new sales, and this growth marked our second consecutive quarter of dealer account growth. In fact, we grew dealer customers by 339 in the second half of 2020 and nearly half of this growth was from Marketplace customers.

We also continued to see strong growth in our website customers. We currently have 4,400 website customers, up 38% compared to a year ago. In the fourth quarter, we had a 138.1 million traffic visits and 22.2 million unique visitors. Traffic and unique visitors were down 6% and 5% year-over-year respectively in the fourth quarter. As we all know, not all traffic is created equal. We remain focused on generating quality traffic that converts into leads and sales and ultimately generates higher ROI for our dealer customers.

We're constantly testing, learning and optimizing our marketing mix to be more efficient and maximize customer ROI. This is evident in the decisions we made in the fourth quarter to invest more heavily in brand and continue to shift investments into channels that generate high quality traffic along with strong lead conversion.

As we look ahead to 2021, we expect to continue to deliver strong ROI to our dealer customers. Remember that traffic metrics alone are not the best way to evaluate our value delivery. Our focus is on generating high quality, well-informed ready-to-buy car shopping traffic and we are delivering. As Alex mentioned earlier, dealer see referral traffic from Cars.com at three times the rate of [ph] the next (00:20:05) Marketplace competitor, and these shoppers buy at twice the rate of a shopper who simply visits a dealer website.

The second and third quarters of 2020 in particular were marked by a surge in traffic and leads related to COVID-19. That is unlikely to be replicated the same order of magnitude on a go-forward basis. We believe continued investment in the CARS brand coupled with maintaining our focus on optimizing our paid channels will deliver the best quality traffic to our dealers and in the long-term of most traffic overall.

Topping off our strong metrics with a 6% year-over-year increase in ARPD and a 4% increase over the previous quarter. Our newest product, FUEL, fueled the majority of this growth and we continue to see opportunity for growth, not just with FUEL but also with our website solutions suite of products, including Online Shopper and Conversations.

As Alex mentioned earlier we grew the penetration rates for both Online Shopper and Conversations to 20% and 27% respectively this quarter. And we believe there is more room to drive subscriptions to these products as we increase our website customers and grow our penetration rates.

In addition, we are focused on cross-selling our solutions-only customers into Marketplace subscriptions. We have a great opportunity to continue to grow ARPD revenue and profitability by simply increasing dealer penetration of our existing digital solutions, which are all aimed at helping dealers sell more cars and operate more efficiently.

Now, turning to a quick overview of the year, revenue for 2020 was $547.5 million compared to $606.7 million in 2019. The vast majority of the decrease is driven by invoiced credits given to dealers in the second quarter during the height of the COVID-19 restriction period.

Total operating expenses for 2020 were $1.4 billion or $528.9 million excluding the 2020 goodwill and intangible asset impairment charge, compared to $1.1 billion $591.3 million excluding the 2019 goodwill and intangible asset impairment charge. This decrease in expenses is due to the operating expense reductions primarily related to marketing and head count spend taken during the second quarter as the result of the COVID-19 environment. The elimination of affiliate revenue share expense this year also lowered operating expenses by $10 million year-over-year.

GAAP net loss for 2020 was $817.1 million or $12.15 per diluted share compared to a GAAP net loss of $445.3 million or $6.65 per diluted share in 2019. Adjusted net income for the year was $70.3 million or $1.02 per diluted share compared to $104.2 million or $1.55 per diluted share in the prior year period. Adjusted EBITDA was $155.9 million or 28% of revenue compared to $167.3 million or 28% of revenue in the prior year period.

We ended the year with a very strong balance sheet and liquidity position. In October, we refinanced our debt on favorable terms extending the maturity date to 2025 for the credit facility and 2028 for our new senior unsecured note. Prior to the refinancing, we had an all-bank structure that was comprised of a term loan and revolving credit facility with a 2022 maturity date. We diversified our lender base by adding $400 million in bonds and lowering our outstanding debt to our bank lenders to $200 million with access to a currently undrawn $230 million revolver. This provides us with flexibility to invest in the business organically and to take advantage of opportunistic M&A in the future.

Net cash provided by operating activities for the year was $138.6 million up 37% compared to $101.5 million in the prior year period. Free cash flow in 2020 was $121.9 million up 52% from $80.2 million in 2019. This incredible growth was driven by lower non-recurring costs and capital expenditures in 2020 as well as favorability in working capital.

Also, keep in mind 2019 included $38 million of expense related to payments to our former affiliate and 2020 included only $11 million, supporting our increase in year-over-year cash flow. Our strong free cash flow generation enabled us to pay down $50 million in debt during 2020 net of borrowings, bringing total debt outstanding to $597.5 million at the end of the year. We ended the year with net debt of $529.8 million, a decrease of $104.8 million year-over-year.

Net leverage was down to 3.4 times and secured leverage was just 1.3 times. And just last month, we made an incremental $30 million voluntary debt payment and still have $55 million of cash on hand at the end of the month.

We are pleased with our current momentum and strong sequential performance. However, the first quarter of 2020 represents a challenging pre-COVID comp for us, particularly on the top line. As Alex mentioned, we grew our dealer customers in both January and February giving us strong momentum for the first quarter.

However, given the decline we experienced in the second quarter last year due to COVID-19, our dealer customers in the first quarter will still be lower on a year-over-year basis, slowing our ability to grow Marketplace revenue year-over-year. While we did see a pickup in OEM advertising spend in the fourth quarter, many are still operating on a more cautious footing and there is also some natural sequential seasonality of lower OEM spending in the first half of the year. We expect continued strong growth in solutions sales including both website products and FUEL, which will positively impact revenue and year-over-year ARPD growth in 2021.

Along with managing through car buying seasonality and uncertain economic times we also plan to continue to increase organic investments with a particular focus on marketing to support value delivery and ROI for our customers, including investments in higher quality, higher converting channels, which often come at a higher cost. In addition, we plan to make long-term investments in the CARS brand, which we believe is a key driver of sustaining our organic traffic strength.

We also expect to invest in resources to increase growth of our existing products and accelerate product innovation. These investments will result in lower sequential adjusted EBITDA margins in the first quarter but higher adjusted EBITDA on a year-over-year basis. We expect adjusted EBITDA margins of between 27% and 30% in the first quarter.

From a cash flow perspective for the full year we expect capital expenditures of approximately $25 million, interest expense of approximately $40 million and minimal cash taxes. Recall that we have a net operating loss and tax credit carry forward position, which will defray our cash taxes in the near term along with tax deductible intangible amortization from, which we will continue to benefit.

In summary our strong top line trends coupled with focused execution and cost discipline allowed us to exit the year with a strengthened competitive and financial position, which we expect will yield growth in revenue and profitability in 2021.

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. 2020 was a strong year for CARS and we have an unmatched set of competitive advantages. Our brand is the category leader in last year our business once again proved its durability. We are focused on creating a great shopping and experience for consumers and customers, not commoditizing them. Our solutions lead the industry and enabling local dealers to compete beyond price and to drive increased profitability by communicating their unique dealership experience. These advantages will continue to drive growth and value for our customers, consumers and shareholders.

Before turning the call back to the operator for Q&A I want to reiterate that we believe and expect that 2021 will be a year of growth at CARS. As consumers embrace car ownership more so now than ever before, dealers clearly have a growth opportunity in front of them. The car has become an extension of our homes and is viewed as safer than public transportation and ride sharing. Favorable credit conditions that made car purchases more attainable for many and the recently proposed new round of stimulus payments should make it even more so.

The outlook for our industry and our business is bright and our strategy is working. We will continue to remain a valuable partner to both buyers and sellers. We will continue to expand our digital solutions portfolio and drive dealer adoption of these important tools for efficient sales and profitability. And we will continue to leverage our cash flow and strong balance sheet to invest in the business, both organically and inorganically, to accelerate our innovation and to drive top line growth. CARS is well-positioned to drive additional shareholder value.

Operator, we're now ready to begin the Q&A session.

QUESTION AND ANSWER SECTION

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

[Technical Difficulty] (00:30:30-00:31:10)

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

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Hey, Good morning all. How are you doing.

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

A

Good Gary. Good morning.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Just a series of questions here. Of these dealers that you're adding, Alex, how does it break down between the franchise and independent segments of the market?

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

A

Sure. We've actually seen solid uptick on both segments of the market, franchise and independent dealers. If you look at our opportunity, obviously we have plenty of room to grow in both. And I think what we're seeing on the solutions side certainly is most of that growth is coming from franchise dealers both for FUEL and Dealer Inspire. But our Marketplace subscriptions are growing in both segments of the market. Used cars are obviously picking up momentum because of a chip shortage, and so that's part of the growth that we're seeing in both January and February of this year. So we're pleased with growth in both sides for Marketplace.

Gary Frank Prestopino
Analyst, Barrington Research Associates, Inc.

Q

Okay. And in terms of Online Shopper and Conversations you gave some statistics of the penetration for Q4, I believe. And what were the comparison percentages there? And what were those versus Q3.

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

A

Sure. Both of these platforms are low penetration today because we're adding websites at a brisk pace, Gary. So even though the penetration rates that [indiscernible] (00:33:07) are roughly in the low 20s, as website sales grow that penetration rate can grow with it.

We certainly see tremendous upside in our solutions strategy both websites as a core but also in Conversations and Online Shopper. I mean, if you pan back they're both in low-single digit percentages of the industry. So these are growth opportunities and platforms for upsells that our sales force is actively adding every day.

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

Okay. And those percentages were as a percentage of your websites, right?

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

Correct. Again if you look at the total market the opportunity here is even greater.

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

Okay. And then just lastly, you gave – talked about website referral traffic that you guys are clipping through at a much higher rate. Is that kind of a new measure of attribution that you're going out and using with the dealerships?

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

It's always been there, Gary, but I think what's happening is dealerships are really evaluating what's driving their sales. So many dealers are using digital retail tools today, and the fact that we're able to deep link our users directly into their digital retail systems, the dealers are starting to see the qualitative aspects of our audience which is converting it two times the rate of all the other traffic forces combined.

And so when you think about how much a dealer spends in search, for example, only to get a small percentage of that traffic to convert versus Cars.com which the majority of the people we're sending into the dealer's website are converting, I think dealers are now starting to recognize what we've been saying all along, which is you can't replicate the high intentionality of an in-market marketplace like Cars.com.

And so we're certainly accelerating the training and education through Google Analytics and our own proprietary tracking tools, PRIZM, but dealerships are recognizing the quality of our traffic more than ever.

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

Okay. Thank you very much.

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

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

Great. Thanks. Let's try this again. Can you guys hear me okay now?

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

Perfect, Tom.

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

Okay. Great. Hopefully someone didn't ask about kind of the marketing question, but it sounds like you guys are maybe considering or have already started sort of maybe retilting your marketing mix a little bit more in favor of a brand-centric spend. So could you maybe just elaborate a bit more on kind of the rationale behind that shift, if indeed it is a shift, and maybe how we should think about kind of the timeline for sort of the payback or the ROI on kind of more brand spend in the mix versus how you guys used to do it before?

And then just a follow up on national advertising, I know it's notoriously hard to forecast, but if you could give us any sense as to your current thinking and kind of the range of outcomes for that line item this year, that would be helpful.

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

Absolutely Tom. I'll start on the marketing mix and then Sonia will add color. First of all, it's hard to not just comment that we had just an incredible year on the traffic side following a really robust 2019. And so, our traffic was up 8% year-over-year. Our UV's up 5% and importantly, our leads' up 13% in 2020. And so the value delivery that we are generating for our dealers is what's driving incredible retention rates and obviously part of the formula for dealer growth.

And so, we made a shift towards investing in the brand in the fourth quarter because we felt like we had nailed the value delivery equation really well throughout 2020. And that again had been building on a strong pickup in 2019.

Our media mix is always going to ebb and flow based on seasonality and what the market requires. And so, we were being very deliberate in terms of investing in the brand to ensure a sustained and strong performance throughout 2020.

I guess the other comment I'd make is that we are going to run up against really tough comps throughout 2020. I think the shelter-at-home restrictions really elevated traffic levels in 2020 which will make it difficult for us to lap that comp, which is why I'd point to quality. We have a steady stream of buyers that we're generating for our dealers and I don't see any challenge in us sustaining our value delivery.

Sonia, what else would you add on the media mix?

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

Yeah. No, I think you've covered a lot of it, Alex. I think overall we expect to see marketing spend increase in Q1 on a year-over-year basis and it's going to be increasing on both the performance marketing side as well as the brand side. But on the brand side a little bit more heavily since that's one of the areas that we pulled back particularly significantly during COVID.

And to Alex's point, I think one of the real differentiators we see for our business is the strength of our organic traffic, and the investment in brand is really going to support the continued health and growth there in our organic traffic generation.

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

Good point. And on the national front, Tom, this business is a little bit lumpy. I think it's always a little bit lower in the first half of the year versus the second half. And so we see that continuing this year particularly because of the chip shortages. OEMs I think are going to be a little bit more cautious in the first half of this year and we'll see nice pickup in the second half which will help on the EBITDA margin side.

But the business is fundamentally, we believe, at an inflection point particularly with the growing privacy implications that are happening. OEMs are realizing that reaching in-market shoppers directly at the source is going to be a more reliable investment than a lot of the data inferred models that they've relied on in the past. And so I think the businesses is well-positioned.

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

Q

Great. Thanks guys. Appreciate it.

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

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thanks for the questions. I guess two. As you [indiscernible] (00:39:34) new dealers, even the Dealer Inspire website, I mean where are these dealers kind of in the curve of adopting more of these solutions Cars.com offers? I mean is there kind of still quite a bit of runway to get kind of more spend to the advertising products?

And I guess the second question is as dealers are really scrutinizing how they're getting leads and particularly digitally, since a lot of dealerships have been closed, how does that tie to kind of dealer growth throughout the year? I mean is it fair to assume maybe dealer counts are starting to accelerate kind of sequentially throughout the year as people start to figure out the best way to get leads? Thanks.

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

A

Thanks for the question, Nick. Well first of all I think one of the things that COIVD did was it accelerated dealers' desire to invest in digital solutions and platforms. And we certainly see this in our DI website business. It went from a business where we were doing more outbound sales to we had a lot more inbound dealer interest.

And obviously part of that was driven by the forced closures of the showrooms. But I think what you saw in 2020 is dealers started reporting record profits. And they were cutting back on their physical staffs in favor of investing in digital tools. And so dealers are very aware now that the digital format is the most profitable and efficient ways for them to run the business, and I think that will have a lasting implication on the industry well beyond COVID.

And so we're seeing the growth on DI websites and our technology tools accelerate across the entire market. I don't think there's a curve here. This is all dealers are now focusing on how do I get to the profitability that we enjoyed during the COVID restrictions.

I think number two, on the dealers evaluating performance, I think this is also where we shine. A lot of other marketplaces are nearly lead arbitrage markets that generated a lot of leads at a very low closing percent. Every dealer out there will say that they closed leads from their own website at the highest rate, oftentimes two times what they'll see in other marketplaces. And we're driving the majority of traffic in the dealers' websites.

And so I think this is one – we made an announcement at [indiscernible] (00:42:03) about our impact on dealer website performance. Dealerships are scrutinizing that and what sources are driving the most traffic into their websites. And we're generating three times more than our nearest marketplace competitors.

Nicholas Jones
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you, Alex.

Operator: Our next question comes from Dan Kurnos with Benchmark. Your line is open.

Daniel L. Kurnos
Analyst, The Benchmark Co. LLC

Q

Great. Thanks. Good morning. Alex, let me just kind of follow up a little bit just on sort of the philosophical way that the whole space is attacking the market here. Obviously the common refrain now is channel conflict between the dealers developing their own digital tools on the digital retail side. And then obviously you have some competitors that are trying to get kind of any perfect pricing to kind of replicate that showroom experience. I know you guys have kind of a wide array. You spent a lot of time talking about the advertising and lead drive angle and increased conversion. So, just may be your thoughts on how you kind of walk the tight rope from here.

And to the second part of my question, I think you made some pretty clear comments – and that, again, maybe I don't want to misread this. But it seemed like inorganic is certainly still part of the equation here. Just curious what tools you think you're sort of missing at this point or the areas where you think based on the product suite you have would be the greatest adjacent areas of opportunity?

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

A

Thanks, Dan. Well, first of all, I think on the channel conflict side, it is not a new phenomenon that dealers want to convert sales on their own properties. That's been consistent since the dawn of our business and I think that's why we've played an active role in helping show dealers that we're a demand gen platform for their own platforms. That's why all of the large branded national entities feature their inventory on Cars.com, because they know it's a high quality reliable source of sales.

That's really the ethos of our business, is we're aggregating demand because consumers are largely undecided about what to buy and where to buy it. And retailers need to be featured in those wells where consumers are making those decisions using our ratings, using our reviews, using our content to help inform what they should buy.

I think as far as the tools go there is a lot of innovation happening in the market where dealers are investing heavily in sophistication to convert more traffic to sales. And that's where our solutions strategy is robust and growing at an accelerated rate. We just won awards as being the best website provider in the category as recent as last week, and we continue to take market share there.

So we think we're well positioned to ride a lot of the growth that dealers are going to invest in their own websites and the tools that they're going to use. And we certainly have – we're just scratching the surface on our – on this business both with FUEL and our website business and our digital tools.

Daniel L. Kurnos
Analyst, The Benchmark Co. LLC

Q

And on the inorganic side, Alex, just maybe thoughts on adjacency. Are there areas that you could kind of shore up that portfolio?

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

A

Well, sure. I think we're just scratching the surface on our existing investments and innovation. FUEL, even though it's a year old, it's barely scratching the surface in terms of the opportunity we have there. And so we feel really good about our growth trajectory on an existing business.

I think if you're asking about what are the other areas we can invest in for growth, I think certainly anything that the dealer today uses human capital to manage, we think we can complement their operation with technology. And so anything that the dealer has workflow that that tends to require labor, you can be assured that we're innovating and testing and learning in terms of how we can bring technology to solve problems to help dealers run more efficiently.

Daniel L. Kurnos
Analyst, The Benchmark Co. LLC

Q

All right, great. Thanks. Appreciate it.

Operator: Your next question comes from Marvin Fong with BTIG. Your line is open. Marvin Fong, your line is open.

Marvin Fong
Analyst, BTIG LLC

Q

Hi, sorry about that. Two questions, just to start with, so great to hear again that the retention rates are very strong. If I missed it, I apologize. Could you just talk about how your prospecting is going, the inflow of new customers and how your efforts are going in terms of recapturing dealer churn during the COVID period? And then I have a follow up.

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

A

Well, two things, Marvin. I'm glad you noted, the record retention rates we think is a function of our great traffic growth and our organic concentration of traffic, right. So dealers know that this is traffic that they can't buy elsewhere, and that is part of our strong retention.

But as we noted, we had strong dealer growth in January and in February. And so that's been steady. But I would also point to our solutions stability here and growth. During the COVID pandemic, dealers didn't cut their website. They cut back on a lot of advertising across the board. It wasn't specific to any performance issues on any vendor. They just cut back. But they didn't on the websites. And so you saw the resilience and the business in 2020 because we weathered the COVID pandemic better than any of our peers.

I think the adding dealers back, we're going to have to – we'll lap the Q2 cancellations from COVID and you'll see a great second half because we're going to be lapping that dealer loss. Sonia anything? What would you add?

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

No, I think in terms of the momentum we've seen in the second half of the year, it's been a combination of dealers that attrited in Q2 related to COVID along with a really healthy new sales pipeline that we've been seeing. So it's a combination of both elements.

And I think to kind of complement what Alex said, I think the attribution game has changed a little bit with COVID with dealers really recognizing the value of the traffic we bring to them along with us leveraging our data, for example about the data we shared with you on DI website referrals.

Marvin Fong
Analyst, BTIG LLC
Q

Terrific. Thanks. And then my follow-up, I just wanted to drill down a little more on the DI business. So the client – the customer base, up 38%. I think you had said the revenue was up 22% and obviously I understand the lag effect as you're onboarding. Can you just kind of update us, I mean, how – or pretty much all the GM dealers onboarded now and then as we look at the FY 2021, can we think about the revenue kind of converging closer to where the client – the customer growth has been? That'd be great. Thanks.

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

Yeah. So we still actually have a number of the original 800 GMs, so we're still in the pipeline for a launch in 2021. I think overall, from a growth perspective at DI, we think there is still a very substantial opportunity for growth here just on the basis of kind of where the existing business is. If you think about the launches that we had in 2020, they were back-half weighted, and so as you look at 2021 we'll benefit from the full annualization of those websites that we launched in 2020 in addition to the remaining GM websites along with our existing pipeline of launches that we have slated for this year.

I mean, it is – it does get a little bit more challenging as the revenue base grows to keep pace with the same rate of growth, but we think we have a lot of opportunity just on the base website business, not to mention continuing to grow our Conversations and Online Shopper upsell. Does that help answer the question?

Marvin Fong
Analyst, BTIG LLC
Q

Yeah. No, no. That was perfect. Thanks so much, Sonia. Appreciate it.

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

Thanks.

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

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC
Q

Yeah. Thanks. Two questions. Sonia, just to clarify on the dealer count, 18,372 when you talk about 4,400 DI websites, I assume that is not 4,400 dealers per se, and is that in the 18,372 or is that separate?

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

A

Yeah. So website customers don't necessarily translate one-to-one for dealer count. However, the 18,372 does include all of the DI dealer customers.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. Because based on the 38% it looks like it was about 3,200 give or take a year ago up to 4,400. But again it's not one-to-one as you say?

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

A

Right. There are going to be some customers, right, who use DI products as well as our Marketplace customers that we effectively [indiscernible] (00:51:30) the two groups to get to the 18,372.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. Okay. And then just a clarification, and you are pretty clear on obviously margins for Q1. Can you just reiterate what you said about sort of the dealer the revenue trend in Q1 year-over-year?

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

A

Yeah. So I think as we talked about, really pleased with the performance we saw in the second half of the year and the momentum that we're bringing into Q1. But nevertheless, it is a challenging pre-COVID comp for us.

And I think from a revenue perspective maybe I'd highlight two of the areas that make it a little bit more of a challenging comp, right. Despite the dealer count growth that we saw at the end of the year and into this year, we're still going to be down on dealer count, which certainly presents some challenges in growing Marketplace revenue.

And then the second component is just a reminder that national revenue does tend to be a little bit seasonal, but it's stronger second half than first half. And that's also a very high margin business, right, which is also flowing down through to the margin range we provided.

Douglas Middleton Arthur
Analyst, Huber Research Partners LLC

Q

Okay. Great. Thank you.

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

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

Thanks for joining us today and have a great rest of the week.

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