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CDK - Q3 2018 CDK Global Inc Earnings Call

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## CORPORATE PARTICIPANTS

**Brian Patrick MacDonald** *CDK Global, Inc. - President, CEO & Director*

**Joseph A. Tautges** *CDK Global, Inc. - Executive VP & CFO*

**Katie Coleman**

## CONFERENCE CALL PARTICIPANTS

**Anthony M. Cyganovich** *Evercore ISI, Research Division - Research Analyst*

**Brian Lee Essex** *Morgan Stanley, Research Division - Equity Analyst*

**Gary Frank Prestopino** *Barrington Research Associates, Inc., Research Division - MD*

**Timothy Wayne Willi** *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen, and welcome to the Third Quarter 2018 CDK Global, Inc. Earnings Conference Call. (Operator Instructions) As a reminder, this conference call may be recorded.

I would now like to turn the conference over to Katie Coleman, Senior Director, Investor Relations. You may begin.

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**Katie Coleman**

Thank you. Good morning, and thank you for joining us for our third quarter fiscal 2018 earnings call and webcast. Joining me on today's call are Brian MacDonald, CDK's CEO; and Joe Tautges, CFO.

Brian will begin today's call by highlighting exciting new innovations we announced this quarter, followed by an overview of our results and highlights for the quarter. Joe will then take you through the details of the third quarter results and our guidance for fiscal 2018.

A few items before we get started. Throughout today's call, references to financial amounts are on an adjusted basis, unless otherwise noted. Reconciliations of the adjusted amount to the most directly comparable GAAP amounts are included in this morning's press release and are available in the Investor Relations section of our website.

I would also like to remind everyone that remarks made during this conference call will contain forward-looking statements. These statements involve risks and uncertainties, including the risks detailed in our filings with the SEC, which could cause actual results to differ materially from those set forth in the forward-looking statements. And finally, we anticipate filing our Form 10-Q later today.

With that, I'll now turn the call over to Brian.

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**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Thanks, Katie. Good morning, everyone, and thank you for joining our call today. This was an exciting quarter for us, as we announced a number of new innovations and had several new sales successes. We delivered another quarter of improving margins and double-digit earnings growth. And while revenue growth isn't where I want it to be, we are taking the right actions to improve our results.

Today, I want to highlight the new innovations we'd launched in Q3 that are important to our long-term revenue growth, and then I'll spend time talking about the highlights from the quarter.

First, I'm excited about the new innovations announced to the market at the recent National Automotive Dealer Association or NADA show, our industry's largest convention. This was our 50th year attending the show, and we had 6 major announcements. I don't know there was ever another year where we had as much to talk about as we did in 2018. We've been making investments into the business, creating innovative new products to drive growth in the coming years. I'm really proud of what our One CDK teams have delivered.

Before the show all opened, we led our first-ever preview event for the news, media and industry analysts. There, we highlighted the recently announced Drive Flex DMS as a service as well as launched the Fortellis Automotive Commerce Exchange, a real game changer for our industry.

Drive Flex received overwhelmingly positive feedback and is like nothing else available for smaller dealers. We've been listening to our customers and have developed a user-friendly, intuitive, cloud-based DMS platform. That means no more VPN or PC requirements. The DMS will be accessible from any device anywhere at any time. We'll also be offering a consumption-based pricing model that flex us with the business drivers of a dealership: system users, sales volumes and repair orders.

The system architecture will also allow us to deliver a faster, easier migration process. We view Drive Flex as a market-changing technology for the industry. And over the coming quarters and years, this will provide us the opportunity to better serve the smaller dealer market.

While Drive Flex addresses a need within the DMS space, the Fortellis Automotive Commerce Exchange addresses the need across the entire automotive industry. The auto industry is changing at a rapid pace, and dealers have found themselves with fragmented, point-to-point solutions that don't work together in a seamless fashion, perpetuating inefficiencies within the dealership and for the overall retail consumer experience.

CDK, as an enabler of automotive commerce, is best positioned to address this problem. Fortellis provides a common platform for integrated solutions to be delivered with secure, streamlined workflows so that dealers can connect better with customers, sell and service more cars and operate more efficiently. We are bringing together dealers, manufacturers, software developers, data providers and our own solutions in a way that is groundbreaking for the entire auto industry.

This type of platform approach has been successful in many other major industries, and now it will be available to the automotive industry as well. The timing is right, and the industry is ready for the next evolution in automotive commerce. We're in the infancy of the launch, and we'll continue to provide updates as we better understand the near- and long-term revenue potential. However, we are very excited about interest to date and the potential new experiences that Fortellis can bring to life.

We also introduced Connected Store 2.0, which enables dealers to move towards a quote-anywhere, transact-anywhere model, and it allows consumers to complete the entire end-to-end car buying process online. CDK's Connected Store differentiates itself to the accuracy of the quote. What is shown online will match in-store, which is a common shortcoming of current point solutions in the market today. This latest product release also streamlines the process for a better user experience, making it shorter, more efficient and enjoyable for the consumer. We are actively working with multiple OEMs to roll out this solution to their dealers.

We're also excited about the strategic alliance between Open Dealer Exchange and RouteOne to address the most challenging and complex part of the retail experience, the finance and insurance process. These 2 organizations have partnered to take a fragmented F&I process to a streamlined workflow that brings together dealerships, lenders and aftermarket providers into one comprehensive solution. By integrating to this solution, we will provide our dealers with an easier and faster workflow, providing a more accurate point-of-sale transaction that leads to faster funding and better cash flow as well as an improved customer experience.

You could see a common theme here. We're all about helping dealers sell and service more cars, driving efficiencies in their business while enabling them to provide a delightful experience for their customers. We were high on attendees' must-see list at NADA, and our total leads were up more than 50% over last year's record-setting performance. Our showing at NADA could not have been done without the hard work and dedication of our employees, working as One CDK to deliver these innovations and represent CDK to the entire industry.

Now I'd like to provide a few highlights from around the business this quarter. Revenues grew 4% year-over-year. I'm particularly pleased with the growth from our core subscription businesses in Retail Solutions North America and International. EBITDA dollars grew 16%, and EBITDA margin expanded 400 basis points to 36.5%. Diluted EPS grew 27% to $0.85.

Since announcing our transformation plan in June of 2015, we have achieved double-digit EBITDA and EPS growth every quarter and have expanded margins by 1,440 basis point since fiscal 2015. Joe will provide additional details on the quarterly financial results and guidance for the year in a few minutes.

We had another strong sales quarter. Our competitive deal pursuit team improved upon last quarter's performance and signed a 20-plus store group as well as 2 groups over 10 sites. Our opportunity remains strong, which is why we're making investments to expand the sales team and our implementation resources to ensure we can meet demand as we head into next year.

This quarter, we also renewed our largest dealer customer to another long-term contract. Along with this, we continue to see high single-digit recurring revenue growth from our 3-plus site dealers. We're also seeing increased activity in website sales related to our recent OEM endorsements. We've made a number of enhancements to our website platform to improve the dealer user experience, and we're recognized by PCG Companies, a leader in dealership education, consulting and in-depth product research, with 2 automotive website awards last month at NADA.

On the International side, we've recently signed a new agreement with a major global OEM in Japan, the largest deal our Asia-Pacific team has closed in the past 10 years. We've been making investments into the business all year and are pleased with the growth that we've seen thus far.

We also remain focused on improving our performance in other areas, including smaller dealer auto site retention and advertising that have both shown weakness this year. Recurring revenue growth in our 1- to 2-site dealer groups declined mid-single digits as a result of continued auto site losses in this segment of the market.

Auto site counts overall declined on both the sequential and year-over-year basis this quarter, primarily due to the previously mentioned churn in the 1- to 2-site dealer segment. We are focused on stabilizing our site count. The actions we have taken to reorganize our sales team, renew our month-to-month customers and the launch of Drive Flex to address the needs of the smaller dealer will help us do so over time. However, we expect sites to be down modestly on a year-over-year basis in fiscal 2018.

Advertising revenue continues to be challenged. Driving growth in this segment can be particularly lumpy, and results have fallen short of what we expected, due primarily to advertising strategy changes from our customers and lower spend compared to prior periods. We've recently made some organizational changes and promoted someone internally as general manager to provide additional focus on the business. We do expect the challenging advertising environment for the near future.

I am confident we have the right team in place to deliver on our growth strategy. One of our greatest assets in addition to our people is a strong balance sheet and strong operating cash flow. We have returned more than $2 billion to shareholders since 2015 and retired close to 20% of the shares outstanding during that time. And we are using M&A to address opportunities in our portfolio to ensure we can deliver best-in-class solutions.

For example, results from the acquisition of Executive Eye continued to exceed our initial expectations. We've increased the installed base by 20% and have another 20% in the backlog ready to install. These short-term results are indicative of what we can deliver at scale with proven technologies that augment our product portfolio.

During the quarter, we completed the acquisition of Progressus, a leading provider of ad tech with expertise in social/mobile advertising for auto dealers. Progressus will complement our exciting -- or existing advertising businesses and allow us to add even more value to dealers and dealer groups and to expand our reach through diversification of our advertising portfolio. This is an exciting time to be at CDK. We are an enabler of automotive commerce for dealers of all sizes, providing the capabilities or access to the capabilities critical to dealers' success.

We have talked a lot over the last few years about transformation, but we have been listening, too. We're listening to our dealers, OEMs, partners and employees. We're taking that input and acting on it. New product innovations, acquisitions, investments into service, implementation and development, and we're not done yet. We'll have more to share with you about the long-term growth and strategy as we head into fiscal 2019.

I'll now turn the call over to Joe, and then we'll take your questions.

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**Joseph A. Tautges** - *CDK Global, Inc. - Executive VP & CFO*

Thank you, Brian. Good morning, everyone. We continue to make good progress towards our transformation plan goals. I am pleased with our performance in a number of areas, including subscription revenue on the earnings growth and improved free cash flow.

This quarter, we increased investment in both operating and capital expenses, targeted at areas that will accelerate our revenue growth. We are expanding our implementation capacity by over 30% given our sales successes, and we're making additional investments into new innovations, sales and service as well. As Brian discussed, we have work to do to improve performance in the 1- to 2-site dealers segment and advertising business. These are areas of focus for us, and we have action plans in place to do so.

Now let me discuss the third quarter results. Revenues grew 4%, which is a result of strong subscription revenue growth in North America and International, offset by weakness from our North America transaction and other revenues as well as advertising.

Revenue growth on a constant-currency basis was 2%. We continued to benefit from foreign exchange rate fluctuations, primarily in the euro, pound and Canadian dollar. EBITDA dollars grew 16%, and margin expanded 400 basis points year-over-year to 36.5%. Margin expansion is a result of subscription revenue growth in both Retail Solutions North America and International as well as benefits from our transformation program and lower incentive compensation.

Pretax margins expanded 220 basis points versus the prior year, primarily due to EBITDA growth, partially offset by higher interest expense and depreciation and amortization. Our effective tax rate was 29.6% for the quarter. Diluted EPS grew 27% to $0.85 per share, aided by earnings growth, lower average share count achieved through our capital returns program and a lower tax rate.

Now turning to our segment results. Our Retail Solutions North America segment revenues grew 1%. Subscription revenues, which account for 80% of the segment results were up 4%, driven by high-single-digit growth from our 3-plus auto sites, which is offset by a mid-single-digit decline from our 1- to 2-auto sites. Average revenue per site increased 5%.

Total North America DMS sites were down slightly year-over-year. Auto sites were down 3%, impacted by loss activity within 1- to 2-site groups, mitigated by site growth in 3-plus sites. Adjacency sites grew 2%. Dealer websites were down year-over-year due to attrition in the portfolio.

Transaction revenues were down 11%, as we continue to see the impact from dropped point solutions. This quarter, we became aware that certain transaction revenues should have been presented on a net basis. The impact of this change was not material to previously reported total revenues and had no impact on net earnings. Therefore, we have made the correction beginning with this quarter on a prospective basis.

Other revenue was down 10%, primarily due to lower hardware revenues related to a hardware replacement program in the prior year. Margins expanded 530 basis points, primarily driven by scale from increased revenues and benefits from the transformation plan as well as lower incentive compensation.

Advertising North America revenues were roughly flat year-over-year. Higher spend from dealers was offset by lower spending from OEM and local marketing associations. Advertising segment margins declined 90 basis points due to a shift in revenue mix.

International revenues grew 21% or 8% on a constant-currency basis, primarily from increased revenue per site growth of 7%. Site counts increased 1% year-over-year. Margins expanded 230 basis points, primarily achieved through scale on revenue growth and benefits from the transformation plan.

Our cash balance was $461 million, of which $247 million is held outside of the United States. Year-to-date, free cash flow was $278 million, an increase of 28% year-over-year.

We repurchased $123 million of shares and paid $20 million of dividends in the quarter, representing a solid start on the calendar year 2018 shareholder return target of $750 million to $1 billion. We ended the quarter at 2.1x net debt-to-adjusted EBITDA. We continue to target a 2.5 to 3x leverage ratio.

Now I'll move on to the guidance for fiscal 2018. We are revising our full year revenue growth guidance to 2.5% to 3%, primarily due to the advertising revenue challenges discussed. Last quarter's guidance included certain expectations related to dealer and local marketing association spend growth opportunities that have failed to materialize. Given what we now know about expected advertising spend levels from our customers, advertising will be a revenue growth headwind for the next few quarters.

We expect EBITDA margins to be 35.5% to 36%, consistent with last quarter's guidance where we expected to be at the high end of the 35% to 36% range. We are maintaining our EPS guidance of $3.23 to $3.28. Our tax rate guidance of 29% to 30% remains unchanged for fiscal 2018. As a reminder, we expect another 3- to 4-point reduction in our effective tax rate in fiscal 2019 when we get the full year benefits of tax reform.

In summary, we are pleased with how our core subscription business is performing, particularly in our 3-plus site groups and International. We have work to do within our 1- to 2-site dealer space and in advertising, and we need to get through the year-over-year comparison challenges we're facing in our transaction and other revenue streams.

As mentioned, we are making meaningful investments into innovation and operations to support our growth strategy, and we remain committed to our fiscal 2018 margin guidance and 40% exit margin target in fiscal 2019. We are in the middle of the planning process for next year, and we'll share those expectations with you next quarter. We are also in the process of evaluating the impact of ASC 606 and will provide further update as available.

I will now turn the call back over to the operator, and Brian and I will be happy to take your questions.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from the line of Rayna Kumar of Evercore ISI.

**Anthony M. Cyganovich** - *Evercore ISI, Research Division - Research Analyst*

This is Anthony Cyganovich on behalf of Rayna Kumar. In your prepared remarks, you had mentioned that your advertising customers have changed their strategies. Can you provide a little bit more color on how the strategies have changed and whether you think this is more of a short-term or longer-term issue?

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Anthony, it's Brian here. Yes, we want to be careful with how we talk about specific customers. But we've seen shifts -- some shifts in the channel spending. And obviously, SAAR started to come off a little bit, so we've seen some budgets being pulled back. It would be the kind of primary factors that we've seen affecting our advertising business in the short term. I think, over time, money will continue to move, dollars will continue to move to digital advertising from traditional advertising. But our visibility over the next few quarters is a little choppy and so we think the advertising business will be choppy over the next few quarters.

**Anthony M. Cyganovich** - *Evercore ISI, Research Division - Research Analyst*

Great. That's helpful. And Just to follow-up on that, I guess, is it your expectation that organic revenue growth could accelerate in FY '19? Or do you feel like this is still going to be a headwind for you?

**Joseph A. Tautges** - *CDK Global, Inc. - Executive VP & CFO*

Anthony, it's Joe Tautges. So I would put the business and look at it in 2 buckets. I'll set aside advertising for the moment and look at our RSNA business and our International business, which are subscription-based, recurring revenue businesses. And when you look at the quarter, this quarter, we grew at 2%. And so when we look out to -- we're in the middle of our planning process right now, when we look at those businesses combined, we see those improving in 2019 from a growth profile from the 2%. We'll share more on our year-end call about guidance as we think about that. And as it relates to advertising, like Brian said, I think when you look at the shift away from -- we -- where we really have great IP is in the hyper-local marketing digital arena. And the dollars we're seeing come out of there are meaningful. And so we'll share guidance there as well and advertisers as we think about it for 2019.

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

And Anthony, it's Brian here. I would just add to what Joe said that you need to also remember that this advertising revenue is, by far, our lowest margin revenue. By far, our lowest margin revenue.

**Anthony M. Cyganovich** - *Evercore ISI, Research Division - Research Analyst*

Great. Okay, just one final question from me. Can you provide what you think your migration time line might be for onboarding your 1- to 2-site customers to Drive Flex?

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Yes, Anthony, that's a great question. For competitive reasons, we're not going to talk about that at this time.

**Operator**

Our next question comes from the line of Brian Essex of Morgan Stanley.

**Brian Lee Essex** - *Morgan Stanley, Research Division - Equity Analyst*

Yes, maybe if I could just follow-up on the wins and losses on the subscriber side in DMS. Any color in terms of -- I think, we have a little bit of understanding that there's some losses at the low end and potentially some share gains at the high end. Who are you losing to? Who are you gaining share from? And then part B of the question, adjacency growth is really strong and how -- basically, what you think the outlook on the adjacency side will be going forward?

**Joseph A. Tautges** - *CDK Global, Inc. - Executive VP & CFO*

Yes, Brian. So when we look at the sites and renewals, we've had a really strong year-to-date amount of renewals of the core. And so when you look at year-to-date 2017 versus year-to-date 2018, we've renewed roughly 4x the amount of sites this year than we have in years past. And so when you look at site counts and the performance of it, it's a reflection of how active we've been around working with our customers to extend their time trench, renew their contracts. And so that's the first piece. The second piece, when you look at the competitor landscape, I'll let Brian talk to that.

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**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Yes. I would say no real change, Brian, in the competitive landscape. I think we continue to be a net loser of sites in the 1 to 2 market, which obviously is a market that we'll address over time very effectively with Drive Flex. When you look at 3-plus and above, we continue to win new sites and grow our site count there, I think I mentioned it in my opening remarks. And we've got a lot of traction with our new deal -- new business development team for new deals. I mean, this quarter alone, we won a 20-plus store group, plus a couple of 10-plus store group. So we continue to do quite well in the upper end of the market, 3-plus and above, and that we feel pretty confident about our position there. And we see churn declining over time here from where it's been over the past couple of quarters. And as Joe mentioned, year-to-date, we've renewed 4x as many rooftops as we did year-to-date a year ago. So we've had a lot of tactical actions and really been pretty effective, and we see that reducing churn on a go-forward basis.

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**Joseph A. Tautges** - *CDK Global, Inc. - Executive VP & CFO*

And this is Joe again. To your adjacency question, listen, we're quite pleased with how that team's performing. The business is growing nicely. We continue to see good opportunities there. And in the other business, I know you didn't ask about it, but I would point out is the International business as well growing 8% this quarter. So I think when you look at the adjacency, International and the work that we're doing in the RSNA business, it's -- we'll see momentum in a number of areas.

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**Brian Lee Essex** - *Morgan Stanley, Research Division - Equity Analyst*

Yes. There was going to be a follow-up on the International. I know you had a -- some management changes there. I mean, what is materially different? The past few quarters have been strong. What is materially different now than in the past? And what's your outlook for sustainable growth rate for International business?

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**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Yes. So we had some changes in the management team internationally, and our new leader there, Neil Packham is very focused on growth and really has the team focused on growth. And that's a little bit of a pivot from the past. Clearly, you've seen that in the P&L so more focus on faster install, driving more sales. As I mentioned in my prepared remarks, we won a major OEM in Japan. That's the largest deal in Asia that we've won over 10 years. That was obviously a hotly sought-out deal by our competitors, but our product won out in the end and our team won out in the end. So I think we see the International business continuing to be a substantive growth -- being substantively growth additive to the overall company. And so we think -- we don't want to give guidance here, but it's kind of growing this year between 6% to 8%, and we think that's the kind of range we'd like it to grow. And yes, we'll give guidance in August, but we'd like for it to grow in those types of levels over the coming years. And we're pretty confident in the team there and our ability to grow the business.

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**Brian Lee Essex** - *Morgan Stanley, Research Division - Equity Analyst*

Got it. Maybe if I could sneak one last one in. Joe, you've been there a little while now, not a full year but enough to get your feet wet a little bit. And you've got a number of different, well, I guess a lot of different changes over the past few years on the management team. Any thoughts on maybe an Analyst Day or an event where we could maybe get an update on the transformation plan so that investors can set expectations what the long-term operating profile of the business might look like? I know there's some debate of -- I guess it's great that you've got the 40% exit rate established out there. And I think a number of investors are confident in that. But in terms of after the transformation, how we should think about the company, rate of market penetration, rate of scale, rate of margin expansion and capital deployment long term, any kind of event where we can get an update with your latest thoughts or after you've had a chance to really dig into the business, what your thoughts are long term?

**Joseph A. Tautges** - *CDK Global, Inc. - Executive VP & CFO*

Yes, sure. Good question. So before I answer that, just from me, just to close out the international piece, the part there that we hadn't talk about is the margin expansion. And so we're pleased with that side of it as well and how margins continue to go up and the work the team has done there. As it relates to your question around how we think about the next phase. I mean, Brian and I spent a lot of time and are spending a lot of time right now around as we get to year-end and think about guidance for next year and sharing what the next year -- the leg of the journey looks like is important to us. And so in whatever form we do that, Brian and I are talking through that. But for sure, you should expect from us after we get through year-end and you start to look to August-September timing, just around how we share about the next -- the future projections, what you can expect from us. I think you'll get a lot more from us as we close up the year.

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

And Brian, I would -- it's Brian here. What I would just add to that as well, this quarterly call, we tried to talk a lot more about our product innovations, Fortellis, Drive Flex, Connected Store 2.0, the partnerships between One Dealer Exchange (sic) [Open Dealer Exchange] and RouteOne. And so we're really trying to make sure that investors understand that there's a real fundamental product renaissance under way here. The company's been quietly investing in a lot of products and technology, and we really brought those to life at NADA. And our leads are up over 50% at NADA. You were there. You saw the excitement at NADA around Fortellis and other product innovations that CDK is coming with. So we've been, obviously, working pretty hard to -- and pretty effectively to expand margins over the last couple of years, and we'll continue to do that. At the same time, we've been quietly working on a lot of product innovations and the product renaissance here at CDK and really bringing in innovation to the industry through Fortellis, Drive Flex and other products. And so investors should pay attention to our script and our products that we started to roll out and the strategic partnerships that we've put in place. And it's fair to assume with the strength of our balance sheet and the strength of our position in the industry that we'll continue to do a combination of partnerships around product investment and in innovation and acquisitions. And as Joe mentioned and I mentioned, I mean, our sales have been extremely strong, very positively strong. So our backlog is high. We're adding implementation resources to get those products put into place at our dealers faster and obviously for the company to get the revenue faster. So we feel quite good about the position we're in and where we are with the products and the innovation that we have and the innovation that's in the pipeline. And it's Joe's job and my job and Katie's job to figure out the right forms to communicate that to investors, so they have a full understanding of the company's strategy and potential going forward.

**Operator**

Our next question comes from the line of Gary Prestopino of Barrington.

**Gary Frank Prestopino** - *Barrington Research Associates, Inc., Research Division - MD*

Joe, could you just give me -- I couldn't scribble this down quick enough. What was the revenue growth in 3-plus point sites in the quarter and the decline in 1- to 2-point sites?

**Joseph A. Tautges** - *CDK Global, Inc. - Executive VP & CFO*

Yes. So I think we said high single digits in the 3-plus sites and low- to mid-single-digits for 1- to 2-sites.

**Gary Frank Prestopino** - *Barrington Research Associates, Inc., Research Division - MD*

And in terms of Fortellis and Drive Flex, those products right now are out and ready to go in the market. You've done all your beta testing. Is that a correct assumption?

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

That is a correct assumption relative to Fortellis. With Drive Flex, we're in the beta phase. So we're still in the early stages there. And for competitive reasons, we're not going to talk much, Gary, about our finance there.

**Gary Frank Prestopino** - *Barrington Research Associates, Inc., Research Division - MD*

No, that's okay. I mean, when you said your leads were up dramatically at NADA, if you're still in the beta there, then Drive Flex -- could it be considered part of that lead growth?

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Yes. I think, overall, there was a very positive buzz about CDK at NADA. So I think it was a combination of multiple things, Fortellis, Drive Flex, Connected Store 2.0, which really brings the ability to buy online with the accurate quotes to the market. I think there's a lot of industry excitement about our -- the partnership between One Dealer Exchange (sic) [Open Dealer Exchange] and RouteOne to streamline the F&I process. So I think there was a combination of things underway that drove unbelievable lead growth for us and interest at our booths and our demos at NADA. And quite frankly, that has continued after NADA. We've had numerous inbound calls and lots of discussions underway with potential partners around Fortellis and how we can bring new experiences to life for the auto industry. So we've -- we're pretty excited about where we are.

**Gary Frank Prestopino** - *Barrington Research Associates, Inc., Research Division - MD*

And then Connected Store would be considered a layered app. Is that correct?

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Yes. So Connected Store, dealers are really -- it's really interesting this year. In particular, I found that dealers were much more interested in. And I talked to a number of dealers that literally came to NADA, shopping, if you will, for their digital retailing solution. So a year ago, I think, a lot -- most dealers were sort of dabbling in a little bit, thinking about it. But this year, dealers really came to -- dealers really came to NADA focused on digital retailing. And our -- we call it Connected Store 2.0, which is the next generation of our product, intuitive user interface experience. And really, the key of our product, the key that we can bring -- and there's lots of point solutions out there, but the benefit of our product is that the quote that the customer gets online, the taxes, fees, et cetera, that a customer will get online will match those that when they walk into the store. There are many point solutions out there advertising online retailing, but they're really just generating leads and really driving a customer experience that often is not good, where the retail customer will get a quote online then walk-in to a dealership, the price won't match, the taxes won't much, the fees won't match, and it really results in a negative customer experience. So we've been really focused in our products and making sure we have a holistic approach that leads to a very good out-of-store experience and in-store experience. And I think that's what's very unique about our product Connected 2.0 -- Connected Store 2.0. And fundamentally, I think that's why we have the interest that we had at NADA, and we have a very large backlog in that product and a number of OEM conversations underway. And we do have one deal with 1 OEM in terms of rolling that out as well across their network.

**Gary Frank Prestopino** - *Barrington Research Associates, Inc., Research Division - MD*

Okay. So in terms of the quote, does this system allow you to directly talk -- directly interact with the sales person to give you accuracy of the quote? Or where is the quote coming from?

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

The quote is coming from our quote engine, which we call Quote Cloud, which is now a service that we have in the cloud and that we are making available to the industry through Fortellis. So it's a very good example of how we are leveraging our intellectual property in our years of history. So we have all the accuracy of the quotes, the connection to the DMS, the taxes and fees, inventory, incentive stacking, et cetera. And the quote comes from what we call our Quote Cloud, which is a micro-service that we're running in AWS and making available to others, leveraging the Fortellis infrastructure. So again, it kind of -- it speaks back to our Brian Essex' question. There's a lot of innovation here at CDK that we've quietly been working on, a lot of innovation and really brought a lot of it to life at NADA. And we kind of -- we gave a long script today to talk to some of that innovation, and that's one of the encouraging things -- we encourage investors to make sure that they look at the innovation that we've rolled out and what that means for the long-term success of the company.

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**Joseph A. Tautges** - *CDK Global, Inc. - Executive VP & CFO*

Gary, one thing I would add as well, just so it doesn't go unnoticed is, you've heard Brian talk a lot about innovation. You've heard him talk about implementation capacity. So -- in our fourth quarter -- in third quarter, we started to make investments of increasing staffing and hiring in a number of these areas given the interest we're seeing. And so our fourth quarter includes a couple cents of investment that we're incurring related to continued ramp of these investments. And to your question and Brian's, I think as we go into next year, we'll have more visibility in our expectations as this plays out over the longer term.

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**Gary Frank Prestopino** - *Barrington Research Associates, Inc., Research Division - MD*

Okay. And then just lastly, I don't want to keep hogging the questions here. But do you have to be a DMS and/or website client to use Connected Store? Or is it kind of an open architecture that it could be used by a competitors' -- with the competitors' DMS?

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**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Yes. Yes, it works better with our DMS. But fundamentally, our strategy is to be open. We're an enabler of automotive commerce through our Open Exchange, and so I think we'll -- we're open.

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**Operator**

(Operator Instructions) Our next question comes from the line of Tim Willi of Wells Fargo.

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**Timothy Wayne Willi** - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

A couple of questions on housekeeping and then 1 maybe larger-issue question. So I apologize if you've given this number out, but in terms of the 1- to 2-dealer site part of North America, is there a right way we can think about it or could you give us like what percentage of North America would fall into that bucket as we sort of try to think about the exposure there as you move through this cycle relative to the growth you're seeing in the plus 3?

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**Joseph A. Tautges** - *CDK Global, Inc. - Executive VP & CFO*

Yes. When we look at the dynamics, Tim, when we look at the dynamics within the portfolio, first of all, when you think about the 3-plus auto site dealers and the dynamics within the marketplace, we're seeing a fair amount of consolidation of the smaller dealers into the larger multi-site dealers. When you think about our book of business, roughly 1/3 of our DMS revenues come from the lower end 1- to 2-site and about 2/3 from the 3-plus. And so yes, that's the details.

**Timothy Wayne Willi** - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Great. And then if I could stay on that one for just a second before another question. When you see these dealer groups merge, whether it's 2 independent, 1 to 2 location saying, hey, let's get together or somebody that's sort of trying to consolidate. Are you seeing instances where there is a pressing need to upgrade as these dealers become larger through consolidation that's creating an opportunity or could create an opportunity in the future? I'm just trying to think what that consolidation activity may mean for you guys in terms of opportunity versus loss.

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Yes, Tim, it's Brian. So that's a great question. I mean, it's definitely -- as industry pressures, as new car margins come down, obviously, dealers are looking to be more efficient and to have the most efficient operations they can have. A big part of that is often running on 1 DMS platform. So as an example, my team was with a pretty large group yesterday that rolled off a lot of stores there, multiple DMSs. And as part of their go-forward strategy, they want to leverage to 1 DMS. And we're, obviously, a very natural choice for that. So we see that trend quite common. We -- one of the big publics that bought a group, that was a competitor, we're -- we'll be rolling that group over to our platform in the coming months. And so we see that quite prevalently. Obviously, we just announced, within our prepared remarks, we just announced the renewal of our largest dealer customer. So that's the very prevalent trend. We don't see that trend changing. We see as bigger groups buy a store, work with us, and we move the store over so they can have a common platform. We never take those customers for granted, or we never take those deals for granted and -- but we work with the customer to find the right way to move the site over, so they can have everybody on 1 platform and get the control benefits and the cost benefits of that. So that's the trend. That's a macro trend that clearly works in our favor, and we see nothing to suggest that, that changes -- that, that trend is changing. And I see some trends that suggests it's increasing as new deals -- as dealers are focused on a little bit of margin pressures as SAAR comes down.

**Timothy Wayne Willi** - *Wells Fargo Securities, LLC, Research Division - MD & Senior Analyst*

Great. Then my last follow-up was just sort of housekeeping on the numbers. Joe, could you just walk us through, I guess, as we think about the next handful of quarters, you referenced no comparative issues around transaction revenue. And just as we sort of think about the models and whether it's expenses or rev growth rates, can you just sort of highlight, here are the 3 or 4 things, whatever that might be, to keep in mind that were sort of lapping or comping against, just to make sure the quarterly modeling is sort of in sync with those dynamics?

**Joseph A. Tautges** - *CDK Global, Inc. - Executive VP & CFO*

Yes. I think when -- good question. I think -- a couple of things I would point out. First, focusing on this year. When you look at Q4, in 2017, there was some timing of one customer that transitioned out, where we got some reasonably sized payments. And so there's another piece of that in our Q4. So when you start to look at RSNA in Q4, along with the noise that's in transactions, and so on the transaction front, the way you should think of it is it's down 11% this quarter. And when you think about it over the longer term, more than half of that is a result of the noise and some of the gross-to-net discussion I had in my prepared remarks. The way you should think about that line performing over the longer term is our site count performance combined with SAAR. And so when you look at fourth quarter, I think, you'll still see a few of these items impacting us. And then as we head into next year and I reflect on this year, there's a lot less of that as we start to enter into next year, and we'll be -- we'll give a very good transparency on our 2019 guidance around what we expect around -- and in the way you're going to hear Brian and I talk more about it is the recurring subscription business base of RSNA and International, how we're thinking about that and then how we're thinking of advertising given some of the changes we've seen there.

**Operator**

And I'm showing no further questions at this time. I'd like to hand the call back over to Brian MacDonald for any closing remarks.

**Brian Patrick MacDonald** - *CDK Global, Inc. - President, CEO & Director*

Thank you for joining us this morning. I'm optimistic about the opportunities we have ahead of us. Our focus on the customer and our pursuit and mission to enable on automotive commerce will make a difference for dealers of all sizes, and we have momentum to carry out into the next year and beyond. I look forward to speaking with you next quarter. Have a great day.

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**Operator**

Ladies and gentlemen, thank you for participating in today's conference. That does conclude today's program. You may all disconnect. Everyone, have a great day.

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