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CDK - Q2 2017 CDK Global Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the CDK Global Incorporated second-quarter 2017 earnings conference call.

(Operator Instructions)

I would now like to turn the conference over to your host for today, Taze Rowe, Vice President, Treasurer and Investor Relations. You may begin.

Taze Rowe - *CDK Global Inc - VP, Treasurer & IR*

Thank you operator. I'm here today with Brian MacDonald, CDK's CEO; and Al Nietzel, our CFO. Thank you for joining us for our fiscal second-quarter 2017 earnings call and webcast. Brian will begin today's call with an overview of our results, followed by some highlights for the quarter. Al will then take you through the details of the second-quarter results and our forecast for FY17.

A few items before we get started. Throughout today's call, references to financial amounts are on an a adjusted basis unless otherwise noted. Reconciliation to the adjusted amounts in which directly, comparable GAAP amounts are included in this morning's press release and are available 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 turn the call over to Brian.

Brian MacDonald - *CDK Global Inc - CEO*

Thank you. Hi everyone and thank you for joining us this morning. Today I'd like to discuss our solid second-quarter results, give you an update on CDK's activities at the recent NADA convention, and then provide you with an update on both our business transformation and return of capital plans.

Second-quarter results continued to show strong momentum. Revenues grew 5% or 6% on a constant currency basis, our EBITDA margin was 32.8%, which reflects 550 basis points of expansion for the quarter compared to last year's second quarter. The quarter benefited from a combination of savings related to the business transformation and solid performance in our business, with continued growth in advertising offsetting a slowdown in DMS.

With a solid first half to the fiscal year behind us, and despite a few anticipated headwinds in the second half, we are increasing our guidance for the remainder of the fiscal year. Al will provide more details on the quarter and outlook in a few minutes.

We recently just returned from the NAD convention held over the weekend in New Orleans. Where we had a very successful show. We were pleased by the level of activity and interest we saw from the dealer community, the energy level was high and we set a record for the number of product demonstrations we did for current and potential customers. The event was an opportunity for CDK to present dealers with an update on our progress in improving customer experience now, while rolling out products that will help define the future of automotive retailing.

We highlighted products such as our next generation website that help drive customer generation and conversion for dealers, and predictive retailing products like our new MenuVantage Platinum platform that helps dealers use data to drive higher revenues. We also showcased our connected store application that helps dealers convert internet traffic into leads and streamlines the automotive purchase process for consumers. Based on the reception we saw for these and other CDK products at NADA, our latest products are meeting the market and we remain confident in our ability to continue growing with our dealer customers.

Now I'd like to highlight a couple of items from the quarter and provide an update on our business transformation plan. First, I'm very pleased to confirm that as we anticipated on our first-quarter call, we reached an agreement on a new three-year contract with General Motors. We look forward to continue to grow the strong relationship and providing GM dealers with market-leading solutions. Second, as we disclosed in our press releases morning, we completed the $1 billion return of capital plan in calendar 2016 as promised. Based on the strength of our financial results, and our positive outlook for business, we believe we have additional capacity for shareholder returns. Al will walk you through our plans to return additional capital in a few minutes.

Lastly, I'd like to give you an update on our business transformation and highlight some of the progress we have made last quarter. One of our most important areas of focus is the workplace efficiency and footprint workstream. This initiative has enabled us to reduce cost by optimizing our footprint and bringing together the right teams in the right locations, which allows us to improve our flexibility, increase the pace of product development and enhance customer service.

Specifically in the second quarter we continued to make strong progress in getting to the right footprint. We closed 5 facilities in the quarter, bringing our total closures in the transformation plan to 10 which is more than half of our target. In conjunction with these closures we continue to ramp up our new state-of-the-art customer service center in Norwood, Ohio. Since we opened this facility in mid 2016, we've added more than 500 employees and we continue to grow in support of our customers. The benefits of this work and other investments are positively impacting our enhanced customer service workstream.

CDKs ongoing investment in services yielding extremely positive results during our customers' critical year-end period. Compared to previous year ends, this year service levels have improved by over 90% in both internet chat and telephone response time. In addition, we've seen a decrease in required service interactions of approximately 15% as we exited Q2 and entered Q3. This is a result of the reduction in the number of software releases, driven up by our MoveUp workstream as well as a 30% increase in client usage of improved self-help tools. There's always room to improve but we feel we are making real strides.

Finally, I wanted to highlight the efforts of the team working on our strategic sourcing workstream. Our first wave of sourcing initiatives are complete and the benefits are reading through our financial results. Based on the success so far, we are increasing our expected savings from this work and the team continues to find additional opportunity.

As Al will discuss in more details later, we are also updating the cost and benefit forecast associated with the transformation plan. As we extend the program into FY19, we see additional benefits from the program but we also expect costs associated with the plan to run higher as we are relying more on outside services and consultants to help speed and optimize the transition. Now I will turn it over to Al.

Al Nietzel - *CDK Global Inc - CFO*

Things Brian and good morning everyone. As I do on each of our calls, my comments for the quarter as well as our forecast will largely be on adjusted non-GAAP basis. Reconciliations between these adjusted results and the most directly comparable GAAP results can be found in the schedules accompanying our earnings release.

We posted very solid results for our second quarter. As Brian said earlier, total revenue growth was 5% and 6% on a constant currency basis. And we continue to see some headwinds from foreign exchange rate fluctuations, primarily against the weaker pound. Also framing my comments on revenues are the KPIs which exclude the impact of foreign exchange rates. These KPIs are also provided in the earnings release.

Our retail solutions North America segment revenues grew 5%, increased average revenue per DMS customer site was the driver of this growth with the revenue impact of DMS site penetration and transactions, basically flat. The number of customer websites declined 1% year over year due to changes to certain OEM programs that began in late FY15. We did however see sequential growth in websites versus the first quarter, suggesting the impact of these programs changes is starting to dissipate.

For advertising North America, revenues grew a solid 18% due to higher OEM driven advertising spend and increased overall advertising spending associated with the calendar year end. For CDK International revenues were down 4% entirely due to the unfavorable exchange rates, but we grew 3% on a constant currency basis primarily from increased revenue per DMS customer site from added users. Site counts also continued to increase on a year-over-year and sequential basis.

Moving from revenues to cost, cost of revenues on a GAAP basis increased $2 million, or a bit less than 1% from last year. This was due to cost associated with the business transformation plan of $10 million versus $2 million last year, which are shown as pro forma adjustments on our non-GAAP tables. Along with growth in advertising cost in the A&A segment.

These items were partially offset by lower labor related costs due to reduced headcount and a more favorable geographic labor mix. Our research and development spend, which is included in cost of revenue, represents about 7% of CDK's overall revenues. SG&A increased $5 million or 5%, included in SG&A were costs related to the transformation plan of $9 million versus $4 million last year which are also shown as pro forma adjustments in our non-GAAP tables and increased stock-based compensation cost. Partially offsetting these costs were benefits due to lower labor related cost from reduced headcount and like cost of revenues, a more favorable geographic labor mix.

Also in our P&L were restructuring expenses of $2 million for the quarter. These primarily represent severance cost incurred in connection with our transformation plan and are also reflected in our non-GAAP tables. Interest expense was $12 million for the quarter compared to $10 million last year second quarter, primarily due to the full-year quarter impact of the December 2015 term loan, and to a lesser extent a partial quarter impact of the December 2016 term loan. Coupled with higher interest expense on existing debt.

Moving on from cost, adjusted earnings before income taxes grew 26% and our pretax margins expanded 420 basis points. Each segment posted strong pretax margin expansion. Retail solutions North America delivered 510 basis points primarily due to lower cost from our transformation efforts, followed by scale from increased revenue. Our advertising segment delivered 500 basis points, driven by scale from increased revenues and lower cost from our business transformation plan. Partially offset by the impact of product mix on the business.

International delivered 390 basis points, driven by benefits of the transformation and leverage on the revenue growth. Total CDK EBITDA margins expanded 500 basis points, 550 basis points year over year to 32.8%. Primarily due to benefits from our transformation plan as well as strength in the business and operating leverage on the revenue growth.

Net earnings grew 37% and diluted earnings per share grew 45% to $0.64 per share. As you saw in our release this morning, we had $4.9 million of benefits from discrete tax items in the quarter including $3 million due to the adoption of the new stock comp standard. This benefited the quarter by approximately $0.03. Our cash balance was $327.6 million of which approximately $200 million is held outside the US.

Now I'll turn my comments to return of capital. You may recall in December 2015 we announced our plan to distribute $1 billion of capital to our shareholders by December 2017, through a combination of dividends and share repurchases. In June 2016 we accelerated the pace of the $1 billion return by a full year to December 2016 and as Brian mentioned earlier, I am pleased to note that we completed the $1 billion return of capital as promised in the second quarter. Executing $20 million in open market share repurchases, a $330 million ASR and paying $20 million in dividends.

As we look forward we continue to see growth in revenue and earnings for CDK consistent with our long-term targets. This growth, coupled with the highly recurring nature of our business, provides us with flexibility to pursue additional return of capital. We now anticipate an annual return of capital via dividends and share repurchases of $750 million to $1 billion in each of the next three calendar years through 2019.

These levels are intended to maximize returns to shareholders while being mindful of the liquidity in our stock and the potential impacts of our repurchase activity on our stock price. The capital return actions will be funded by our strong free cash flow generation and from additional borrowings. We anticipate that incremental borrowing will bring our overall leverage, measured by the ratio of net debt to adjusted EBITDA, to a range of 2.5 to 3 times over this period.

And we believe these leverage ratios continue to reflect the strong balance sheet that will provide us with excellent access to capital. In the event that other opportunities such as significant M&A require the use of cash or debt capacity, we may slow the pace of the returns temporarily to maintain that balance sheet strength.

Now before I turn to guidance I wanted to provide an update on the financial impacts of our business transformation plan. In August we extended the measurement period for the plan which originally ran from FY16 through FY18 to include FY19. Over that period, we now expect benefits of approximately $300 million, up from $250 million $275 million. Our forecast for the FY17 also has increased to $95 million to $105 million from $85 million to $95 million.

Also, we now expect the overall cost of the plan to be $225 million to $250 million, up from the original estimate of $150 million. This is due to the extended transformation period and increased benefits, coupled with the greater than originally anticipated use of outside resources and consulting services needed to accelerate the projects and improve outcomes.

Moving on to the forecast for FY17, for our forecast the year-over-year comparisons are again on the as adjusted basis. Due to the strong performance in the quarter and despite anticipated increases in expenses related to interest expense and stock-based compensation expected for the remainder of the year, we are increasing our adjusted full-year earnings outlook. We continue to anticipate 4% to 5% revenue growth which includes 1 point drag from foreign exchange rates.

We are increasing the range of pretax earnings growth to 23% to 26% from 21% to 25%. And increasing the lower for EBITDA margin expansion to a range of 550 to 575, up from 525 basis points in our prior forecast. Our anticipated effective tax rate is modestly lower at 32.5% to 33%, compared with 33.8% in FY16. The decrease in the rate is primarily related to the tax benefits associated with the adoption of a new stock-based compensation accounting standard on July 1.

Most of these benefits were realized in the first half which implies an effective tax rate approaching 34% for the second half of the fiscal year. The new standard will continue to affect our provision for taxes resulting in increased volatility in our rate going forward. We are increasing the ranges of both net earnings growth and growth in diluted earnings per share to 26% to 29% and 34% to 37% respectively, resulting in an anticipated diluted earnings-per-share range of $2.33 to $2.38. The forecast includes future repurchases in the later part of the fiscal year as we start to implement our new leverage targets.

And as we've discussed in prior calls there are a number of items that result in slower year-over-year growth in pretax earnings in the second half of the year. First, we anticipate incremental interest expense over FY16, which will create pressure on the year-over-year comps. We estimate the total incremental interest expense in the second half to be $10 million to $15 million. Second, as we execute our transformation we anticipate incremental stock-based compensation expense in our fiscal fourth quarter of $10 million to $15 million.

There is no anticipated material impact on quarterly comparisons related to foreign exchange rate movements. In summary, this forecast represents solid progress toward our transformation targets to achieve a 35% adjusted EBITDA margin for FY18. With that, I'm going to turn it back to the operator and Brian and I will be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Matthew Pfau, William Blair

Matthew Pfau - *William Blair & Company - Analyst*

Hey guys, thanks for taking my question and nice quarter. First wanted to touch on the macro-environment you're seeing out there in terms of your customer base, has there been any sort of hesitation or change in attitude as there's some uncertainty now about potentially trade agreements or border tax adjustments?

Brian MacDonald - *CDK Global Inc - CEO*

It's Brian here Matt, I would say our customers, I mean the dealers are fairly bullish, volume was obviously good last year, December was a very good month. January was soft but I think people are still expecting a pretty good year in terms of volume. I think there's obviously a certain degree of uncertainty around some of the border tax issues that have been raised as potentials and I think the various dealer groups are getting together to start to lobby on those and first kind of understand the impacts with their respective manufacturers.

But I think putting that aside and the uncertainty that that has, I think people feel like this is going to be a pretty good year from a volume perspective. And obviously volume was good the last couple of years and I think our dealers are feeling pretty good about volume this year.

Matthew Pfau - *William Blair & Company - Analyst*

Got it. And then wanted to touch on the combination of digital marketing and the segment now, I guess it's been about two quarters that they've been together, can you talk about any benefits you're seeing there in terms of cross sell or anything else from combining those two segments together?

Brian MacDonald - *CDK Global Inc - CEO*

We organize the Company, not just those segments, but we reorganized the whole Company effective July 1. And it's actually interesting, I think it was probably in September or October I said to the management team that for a Company that just reorganized itself, probably the most significant reorganization of the Company in a long time, if not ever, we were operating pretty well and I think our results speak to that.

I mean, we are getting benefits on multiple sides, on the product side we've reorganized the way we develop product and really have a consumer facing product group and a product mentality. In particular that brought together our digital assets and some of our baseline assets. On the sales side we see good integration, we have better face-off to the OEMs in terms of the whole suite of products and services that we are doing. We have all sales under one very capable leader and so we really have a much better coordinated sales effort between what we're getting the OEMs to partner with us on and products and services that OEMs want to drive at the dealerships.

And then obviously we have our traditional sales force which is very strong and feet on the street at dealers and dealer groups. So we are pretty happy with how this has come together, quite frankly, and I think the results speak to that. Last week at NADA one of the themes we here at the Company is, we call it one CDK where we are really trying to leverage all of the assets of the Company to benefit the customers.

It was interesting last week at NADA a number of dealers said to me that they really felt the Company was one Company, it wasn't very siloed which I think is historically a customer criticism of CDK, that we were very siloed, we didn't present ourselves to customers with a common face. So last week at any NADA we got a lot of positive feedback about the way that we presented ourselves and the customers can see that trickling through to our products and our services and the way we face off against them. So, overall very happy with the reorganization and how we are operating under it.

Matthew Pfau - *William Blair & Company - Analyst*

Got it and last one for me, just wanted to touch on the subscription revenue line item, it decreased slightly sequentially, Al maybe if maybe a little more detail on what kind of drove that?

Al Nietzel - *CDK Global Inc - CFO*

Yes, there's no real color on that other than just normal seasonality that we have in the business from a dollar basis. There's a little bit of translation on the -- but not a whole bunch, ultimately there's nothing unusual on that at all.

Matthew Pfau - *William Blair & Company - Analyst*

Got it, perfect, thanks guys appreciate you taking my questions? Sure.

Operator

Ian Zaffoni, Oppenheimer

Ian Zaffoni - *Oppenheimer & Co. - Analyst*

I wanted to dig a bit into regards of the performance at retail solutions in North America. With the roughly 1% decline in sites year over year, I know you mentioned there were transformation reorganization factors that impacted it, I wanted to check and see if there were any detailed insights on contracts in the pipeline between auto and the adjacencies to drive growth going forward, and just to help think about the segment performance going to 2017 and 2018 following the transformation

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Al Nietzel - *CDK Global Inc - CFO*

Let me take a crack at that. I mean at the end of it the overall RSNA site counts with the adjacencies and motor cycle, marine RV and heavy equipment are actually up, but your comment on the auto segment is correct. There was a slight deterioration sequentially quarter to quarter and it really just reflects some of the competitiveness of the market that we are in right now, obviously.

What we're seeing is that, particularly at the lower end of the market there's far more competition and we're making some decisions on market share and whatnot. You'll notice that the average revenue per site is up, so it implies that some of the sites that we are losing are some of the lower revenue items but we are expecting to see this, again, this continued pressure in the market relative to competition

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Ian Zaffoni - *Oppenheimer & Co. - Analyst*

Got it thanks for that, going forward you might be targeting higher-margin customers?

Brian MacDonald - *CDK Global Inc - CEO*

Brian here, look we want to have more customers, we want it to be a valuable relationship for them and for us. We generally vector toward larger customers because of the nature of our product as Al said, and we're going to have more customers where it makes sense for them and for us.

Al Nietzel - *CDK Global Inc - CFO*

And our sales team is absolutely focused on continuing to gain conquest in market share and so forth, so that's a continued focus and will be for CDK for a long, long time

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Ian Zaffoni - *Oppenheimer & Co. - Analyst*

Got it, thank you. Thank you for the color. Great quarter, thank you guys.

Operator

Gary Prestopino Barrington Research

Gary Prestopino - *Barrington Research - Analyst*

Good morning, everyone. I guess, Brian, at the beginning of your comments you talked about headwinds, so the headwinds really are what you just addressed in the last question, and it's just becoming a little more competitive at the lower end?

Brian MacDonald - *CDK Global Inc - CEO*

Yes, I mean I think we have a couple of financial headwinds in the second half of the year versus our first and we have higher interest expense, some higher stock-based comp expense, so that's primarily what we are getting at, Gary. Yes, look, it's a very competitive market especially at the low end and our job is to manage our combination of discounting and site growth and make sure we are getting the right balance.

If we're gaining sites but we're not gaining sites by overly discounting and real focused on the products we have, some of the stuff that we talked about earlier that we highlighted at NADA like our next generation website, connected store product. I think we've got to sell the value of our product set and not sell on price.

Gary Prestopino - *Barrington Research - Analyst*

No-no that's fine you know considering the switching cost to remove a DMS incumbent like what happened with Hendricks, you really have to get more average revenue per DMS user. And so the next question would be, you mentioned three new products that you talked about, could you maybe just drill down on the specific competitive advantages or just advantages of these products that you're going to be rolling out, or you have rolled out and you showed at NADA? I think there was websites, there was a retail product and then I'm particularly interested in the connected store application, what's the functionality there?

Brian MacDonald - *CDK Global Inc - CEO*

Let me start with our websites. Our websites are responsive, they're very easy to modify, you can see we've rolled them out across the majority of Lexus stores. They worked very well in mobile which is where 75% or 80% of the customers are coming in through a mobile device, and that's been connected with our suite of advertising services.

So if you can look at some Lexus sites and you'll get a sense of the website. And then underneath that one of the key benefits is our ability to basically update the sites very quickly for specific merchandising offers, other particular things that the dealer wants to do. We'll be rolling those out across all the GM brands as well this year.

And then on connected store, some of the features of connected store -- really connected store as we call it is meant to bridge the out of store and in-store experience. So you can basically start your purchase process online, leverage our quote engine and basically get an accurate quote including taxes and fees and basically do as much of the buying process as you want online.

Different customers obviously have different appetites to do a soft credit app, a full credit app online, and different dealers have different philosophy about how much they want to happen outside the store versus inside the store. So basically we have that product, it's in general release, we've got a lot of interest in that product from some OEMs who want to white label it for their brand. And a lot of interest from different dealer groups.

So really the way to think about that product, Gary, it's really allowing you to do the purchase process online and we're kind of ultimately will have digitized contract for that process, full credit, we have a full credit app. Now different states require you, as you know, to sign physical papers so some of the limitations of the digitization of the processes are driven by different by state requirements.

But that is a product that has a tremendous amount of interest from the customers and it's in general release already and we have it at some customers already and it's an interesting product because we really have interest from dealers, dealer groups and OEMs, and we'll ultimately white label that for some OEMs and they will move it across their entire brand.

Gary Prestopino - *Barrington Research - Analyst*

Okay, was there a certain product Brian predictive retail product?

Brian MacDonald - *CDK Global Inc - CEO*

We have another product, an F&I menu which is an exciting product, it got a lot of interest at NADA. It basically uses some predictive data and analytics to offer the customers some F&I products that are more suited to them. Very easy to use, again it's connected in with our quoting tool so that very quickly you get a revised monthly payment or lease payment, a financing payment, whatever the customer is looking at in terms of their options. So that product is in general release, it's in the market, we are selling it and installing it and that got a lot of interest from customers last week at NADA as well.

We're also getting very good traction with our product, which is a tablet-based product for an improved service experience, so we've gotten really good traction with that product in the last four or five months and we see the penetration rate moving up in terms of the attach rate relative to our DMSs moving up. We have a white label version of that product for a major OEM that they're rolling out across all of their dealers as well, so that's a pretty exciting product that's been getting traction as well.

Gary Prestopino - *Barrington Research - Analyst*

One last question, with all these products that you cited, do those work with competitors' DMS sites as well, or does it just have to be on the CDK dealer side?

Brian MacDonald - *CDK Global Inc - CEO*

No. They can API into the majority of the competitive DMSs.

Gary Prestopino - *Barrington Research - Analyst*

Okay, thank you

Brian MacDonald - *CDK Global Inc - CEO*

Thanks Gary

Operator

Rayna Kumar, Evercore ISI

Rayna Kumar - *Evercore ISI - Analyst*

What factors would cause you to be at the low-end of your 2017 margin target versus the high end?

Brian MacDonald - *CDK Global Inc - CEO*

Hi, it's Brian we have, as I mentioned we have pretty exciting stuff going on with OEMs and where they may want us to roll out some of our products or websites. So we have some pretty exciting stuff going on with them that if that comes to fruition we will incur some cost, upfront cost for that development in this year and then obviously the benefit will come next year, so that's one side of that. I think the other side is, we have some programs with some OEMs that we expected to rollout, some of those have been delayed, not because of our decisions but because of other factors, either at the OEMs or the dealers. I think that maybe push us out a little bit, Al do you want to add to that?

Al Nietzel - *CDK Global Inc - CFO*

We talked about a couple of opportunities potentially internationally to accelerate a few things. We feel very good about, Rayna, where the guidance sits right now. The second half of the year due to the challenging comps within the advertising segment, because last year was when it really started to click up. So the revenue in the second half of the year is lower than what we have in the first half, particularly in advertising, but we feel pretty good about -- very good about at the range of our guidance.

Rayna Kumar - *Evercore ISI - Analyst*

That's very helpful. It's good to see the GM contact renewal, are the economics similar to your previous contract?

Brian MacDonald - *CDK Global Inc - CEO*

We're not going to about economics of a major contract like that, suffice to say that we are very happy and excited to continue to work with General Motors and we are just not going to talk about specifics of a contract.

Rayna Kumar - *Evercore ISI - Analyst*

Thank you

Brian MacDonald - *CDK Global Inc - CEO*

Thank you

Al Nietzel - *CDK Global Inc - CFO*

Thanks Rayna

Operator

Brian Essex, Morgan Stanley

Brian Essex - *Morgan Stanley - Analyst*

Hi, good morning, thank you for taking the question. I was wondering if you could talk a little bit about the progress in your transformation effort? If we look at gross cost takeouts and Brian I know you indicated that you're investing in operations, is there any way to kind of quantify or at least give us some kind of sense? It seems as though you've made some nice progress in the transformation effort and so what is left on a gross basis and where are we spending in terms of cost and net against that gross savings?

Brian MacDonald - *CDK Global Inc - CEO*

I think what Al updated today, Brian, I think get to that. We expect to, over the life of this program spend $225 million to $250 million for net benefit of $300 million. So that's pretty good return on investment. And we've obviously, you can look at the P&L, we're obviously moving the margin up with a pretty good trajectory.

So there is more to do, every day here we are chopping the wood here every day and it's hard work. Clearly we're making good progress on the P&L, you can see the benefit in the P&L. We have all the workstreams detailed for you guys, I'm not going to go through that today. We've detailed all of our workstreams, whether that's moving to, improving our customer service, strategic sourcing, footprint rationalization. And what we've been doing each and every quarter is giving you an update on some of those in a level of detail, we don't have time to go through all 9 or 10 of them.

But today we updated you that we are halfway through our facility closings, we have 20 facilities to close and rationalize and we finished 10 of those so far. So as I said, we're making good progress, we clearly have more to do, we are very focused and we continue to find some new opportunities along the way, that's why we've bumped up the target to $300 million and extend it through FY19

Al Nietzel - *CDK Global Inc - CFO*

The benefits, Brian, we are really seeing through the P&L where we've got earnings growing at a far greater rate obviously than revenue, due to the combination of cost take out and some scale that we get in the business, so I know we'll spend some time together after but we've made some really good progress. As Brian said, there's a lot to do yet, there's continued opportunities to serve the clients and develop products quicker and faster and support our clients in the way that they need to be supported, and we are seeing good traction.

Brian MacDonald - *CDK Global Inc - CEO*

One of the things Brian, I just did this math myself, I don't have it right front of me. But if you go and you look at our -- look at the first two quarters of this year, our revenue is up maybe $63 million or something and then you look at our EBITDA, our EBITDA is up $79 million, right? So just looking at those two numbers, putting the two quarters together and looking year over year, I mean that's gives you a sense of the magnitude of the benefits of the transformation right there.

Brian Essex - *Morgan Stanley - Analyst*

Right, that's helpful. And I guess if I think about, I mean you guys don't break out R&D, but you've had quite an acceleration with new product development recently, how should we expect -- how has R&D trended historically and how should we expect that trend going forward given that you've had this rollout?

Brian MacDonald - *CDK Global Inc - CEO*

Our R&D is 7% of revenue, give or take a little bit. I mean we have some things in the products we need to make better, obviously. We have an effort to get to what we call end, which is a common version. And look, this is obviously a very competitive market, this is technology space, there's lots of innovation so we need to continue to innovate the product, and as I like to tell the customers and the employees we are transforming CDK and we're finding opportunities to cut costs and be more efficient

But the things that impact our customers, services and products, we are investing in those and we're making those better, we talked about service today, our service is dramatically better than it was a year ago and we continue to invest in product. We are not cutting spending from R&D and we are really focused on products and I always tell our dealers and our employees that we are transforming the Company and we are looking to be more efficient. But the things that impact customers, products and services, are not places that we're cutting costs, those are places where we are investing for a better experience.

Al Nietzel - *CDK Global Inc - CFO*

We really see the benefits of the reorganization that Brian did shortly after his arrival where we can stretch the R&D dollars more efficiently and it's all part of the moving up initiative. I think you've Brian mentioned before prior to the reorganization, we had six or so different R&D organizations led by different people that used different tools and different processes and that is been a big win for our technical community and we are seeing results that are paying off.

Brian Essex - *Morgan Stanley - Analyst*

That's helpful

Brian MacDonald - *CDK Global Inc - CEO*

I'll give you an example, Brian, this is very encouraging. We obviously have been reducing our versions of N, software versions and made very good progress last year. And looking at November and December, the service interactions we had were down by double-digits overall, right, which I think is a function of having less versions, higher-quality. And then year-end accounting is extremely difficult -- busy time for dealer finance departments, right? And our service interactions from a service interactions related to year-end accounting and customers needing help or having questions, those are down roughly 20% year over year.

Our service levels are thereby 90%-something versus a year ago. So fundamentally, we see the benefit of reducing the versions of the product and having more consistency in the product and we see that benefit coming through in terms of the customer interaction, service interactions we have to have which is obviously good for the dealers, they don't need help, or they don't have a question or an issue and it's good for us because we're not getting those interactions.

Brian Essex - *Morgan Stanley - Analyst*

Got it, very helpful, thanks. Maybe last one, apart from the salesforce changes, any other incremental thoughts there? Is that done or any more to go, and what do you see as incremental transformational challenges coming up in the next of couple years? I think that was a pretty meaningful one in our view and it's nice to see that you've had some progress there, but I just wondering what else are you focused on going forward that you have to get right?

Brian MacDonald - *CDK Global Inc - CEO*

We have some big system changes, we have a lot of complexity in our billing process, a lot of older legacy systems that we are combining into one system, that's a very big project for us. Because one of the biggest complaints from our customers is about our billing and the complexity of our billing and that has a lot of upstream benefit in terms of how we quote, how we bill, how nimble and agile we can be in that process, so that's a big one that we are working on. Any systems implementation in any Company is obviously complicated and risky, so that's a big one for us.

We have a lot great work underway around getting to N, and I think we are probably somewhere around 950 versions of N, maybe a little less now, we started at 1500 so we've made good progress but we have a lot more to do. So that has a big impact as I talked about before, affects service, affects the release process and ultimately our billing and other things. I think that's a workstream that we definitely have to get right.

And we have a lot of little things, I always like to tell investors that there isn't two big things we are doing here, there's 100 projects, right, there is 100 projects of things that we are doing. We have a formal project management office, we have consultants helping us and some of the projects are small and some of the projects are big, but there's just a lot of -- there's just a lot of pieces of this that we are doing and we're obviously getting good results and making great progress. But we also have more to do and we remind ourselves of that everyday when we come to work.

Al Nietzel - *CDK Global Inc - CFO*

The one comment Brian made about the contracting process, I mean we were just at the show in New Orleans and I had multiple conversations with dealers just about what it takes to contract with CDK, and it's a painful process that we have to make easy for both our sales organization, because it winds up taking time on them, and also the client experience. So we are putting a lot of shoulder right now behind an internal project to revamp our quote to cash process and we're driving a lot on it.

Brian MacDonald - *CDK Global Inc - CEO*

But just to be clear, are contracting process is a little funky because of our old systems, but we're not hard to deal with. We're easy to deal with. Right.

Brian Essex - *Morgan Stanley - Analyst*

Very helpful thank you.

Operator

Ladies and gentlemen, this does conclude our question-and-answer session. I would now like to turn the call back over to Brian MacDonald for any further remarks.

Brian MacDonald - *CDK Global Inc - CEO*

We appreciate you joining us this morning, thanks again. As we have highlighted, our very solid second-quarter results show continued progress towards our goals for FY17 and beyond and allows us to raise our guidance for the year. The 550 basis point increase in our adjusted EBITDA margin, to 32.8%, shows great progress towards our 35% target for FY18.

We continue to make real progress in the transformation of our business to make it more efficient and improve service for our customers. And as we demonstrated at NADA, we have products that are driving significant dealer interest as the dealer community looks to the next generation tools to drive the customer interaction. Thank you for listening and have a great day.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes today's program, you may all disconnect, everyone have a great day.