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CDK - Q2 2019 CDK Global Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 05, 2019 / 1:30PM GMT

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the CDK Global Second Quarter Fiscal 2019 Earnings Call. (Operator Instructions) As a reminder, today's conference is being recorded.

I would now like to introduce your host for this conference call, Ms. Katie Coleman, Senior Director, Investor Relations. You may begin.

Katie Coleman - *CDK Global, Inc. - Senior Director Finance*

Thank you. Good morning, and thank you for joining us for our second quarter fiscal 2019 earnings call and webcast. Joining me on today's call are Brian Krzanich, CEO; and Joe Tautges, CFO.

A few items before we get started. Throughout today's call, unless otherwise noted, all references to financial amounts are on a non-GAAP adjusted basis. And for purposes of comparability, all results and year-over-year comparisons are presented in accordance with ASC 605. 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, it's my pleasure to turn the call over to Brian.

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Thanks, Katie, and good morning, everyone. I'm excited to report our second quarter results to you today as well as update you on the strategic initiatives that are critical to continuing the strong momentum we saw this quarter.

Q2 was a record quarter on both the top and bottom line. Starting with revenue, we saw total company growth of 7% and 9% growth in core auto software. We are encouraged by this performance and will continue to build on this momentum with the many revenue initiatives we have in the pipeline that I'll discuss further in a moment.

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Growth was largely attributable to a strong quarter in our retail sales North America's business, which grew 12% as a result of the ELEAD acquisition and growth acceleration in key layered applications.

Rounding out core auto software, our International business grew 1% on constant-currency basis. We are executing on a number of opportunities that will accelerate growth in International as we head into the next fiscal year.

Moving to the bottom line, total company EBITDA and EPS grew 12% and 15%, respectively. We're especially proud of this performance because it was achieved while we continued to make investments in key growth areas like implementation, Drive Flex and Fortellis.

During my first 90 days, I have spent time listening to our customers and employees to better understand and build our strategy moving forward. CDK exists to provide great automotive ownership experiences to our dealers, OEMs and their customers. And we do this by delivering world-class software, support and data insight.

Our strategy centers on 3 key areas: first, shoring up our core business by providing world-class customer support and solutions at levels never before experienced by CDK customers; second, driving innovation with new revolutionary products like Drive Flex and Fortellis; and lastly, using our data

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to provide key insights that allow our customers to grow and be more profitable.

I want to be clear that Joe and I and the entire leadership team here at CDK are committed to delivering this strategy in growing revenue at a rate faster than spending, and this is key to the strategy in delivering true value to our shareholders.

We shared these themes with the dealer community at this past month at the NADA Show, the premier annual expo for franchise new car dealerships. It was my first time attending the conference, and I was astonished by the level of excitement surrounding recent developments at CDK.

As a company, our #1 focus is improving customer satisfaction. To facilitate this, we have continued to deliver enhancements to our dealer's experiences during key milestones of their relationship with CDK. As you will recall, we've increased our implementation capacity this year. We will also be investing further in a post-implementation support team and our customer success organization during the second half of the fiscal year.

As part of the customer success enhancements and to improve our customer support levels, we've extended our hours of availability by 30% to better correspond with dealers' peak car selling hours, especially those outside of the standard work week. And this change will improve sales efficiency for many dealers who have high volumes during nights and weekends.

We're also launching a customer success dashboard that links dealership performance KPIs to usage of our software. The dashboard will help dealers manage and improve their business, while giving us the opportunity to clearly demonstrate the value of our products in enabling their success.

Improving customer satisfaction is a holistic effort, and we're confident in the many changes we're making. The feedback we received at NADA and the early signs of success we've seen in our results have indicated to us we're on the right track.

Our retention of at-risk customers improved 20% in the past 2 months versus the first 5 months of the fiscal year, a sign that our customer satisfaction efforts are beginning to materialize in the results. While this is only a couple of months worth of data, the trend is encouraging as we doubled down on our many customer-oriented initiatives.

Now let me turn to our product and innovation initiatives. As we've mentioned in previous calls, the acquisition of ELEAD dramatically strengthened our portfolio of layered applications, specifically within our front-office applications, which include CRM.

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Many of our integration activities are focused on rationalizing our front-office portfolios through a best-of-breed effort. One example of this is that we have recently completed the integration of the ELEAD CRM to our Connected Store offering, which enables dealers to synchronize the online-to-in-store car buying and selling experience.

We're also intent on instilling best practices for sales and retention across our combined company. As we've previously shared, strengthening our front-office portfolio allows us to develop richer and deeper relationships across our customer base of approximately 9,000 auto sites.

We also have the opportunity to expand our reach beyond these sites by deploying a DMS-agnostic approach focused on selling layered applications, such as CRM, Connected Store and service to the approximately 11,000 non-CDK auto sites in North America.

ELEAD has a very strong sales team that has built on selling to all franchise dealerships. Successfully executing this go-to-market strategy can effectively double the reach for many of our layered applications. As the integration continues, we're also learning more each day about the ELEAD account management practices that have led to the high levels of customer retention and identifying opportunities to adopt these practices in other parts of the business. This directly complements our focus with the broader CDK organization on improving satisfaction and retention.

Moving to the areas of innovation, I couldn't be happier with the progress made this quarter. We've made tangible progress on the development of Drive Flex, our next-generation DMS solution, which makes us very optimistic about its future, both for the 1- and 2-site segments of dealerships where we've seen higher attrition as well as for the broader DMS market.

Drive Flex's development represents a milestone not only for CDK but for the auto industry at large. In our view, it's the most technologically advanced DMS, and it has been engineered to improve usability through our modernized architecture, reduce training time through our refreshed and intuitive user interface and enhanced data availability with the OEM integrations required to run a franchise auto dealership.

Drive Flex is now in use, and the early reaction has been positive. Dealers have provided feedback that they are able to jump right in with practically no training. They like the simplicity of the workflows, which will make them more productive and efficient, and allow them to spend more time with the customer instead of in front of the screen. In the second half, we are accelerating our efforts and allocating more resources to Drive Flex in order to expedite further development and its ramp into more dealerships.

Now moving on to Fortellis. We're betting on the future of automotive technology being one that is built on openness and broad-based innovation, rather than one of siloed data and top-down innovation, as has historically been the case.

With open API management capabilities, a secure, scalable infrastructure and modules such as an app store, Fortellis will allow us to deliver an entire marketplace of new tools to dealerships and OEMs by giving developers and third-party technology companies access to innovate on the back of our platform.

The Fortellis marketplace is now live and APIs are currently being consumed. We held our first-ever developer day at NADA. We had over 60 attendees from across the globe, including dealers, OEMs and independent software vendors, both large and small. There were 3 APIs and 1 solution published during the event.

Our partnership with Lyft and SiriusXM are some of the more notable early-use cases, and we believe there are many more that can and will be developed on the platform. We are excited as ever about Fortellis' long-term value proposition, both for CDK and the automotive ecosystem as a whole. We'll continue to provide periodic updates as the platform matures.

That concludes our highlights from NADA and the quarter. And before I pass it off to Joe, I want to emphasize how excited I am about our growth opportunities and the strategies we're employing to realize them. The results this quarter are exciting, and it gives us confidence we're doing the right things. The leadership team and I are committed to the growth framework we've laid out previously, all while ensuring we make necessary investments to enable long-term sustainable growth, while continuing to grow revenue faster than spending.

And with that, I'll turn it over to Joe.

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

Thank you, Brian. Good morning, everyone. I'm encouraged by the results in the quarter and the momentum we are seeing in revenue, profit and cash flow growth. Our current execution, along with our accelerated progress in our innovation pipeline, gives me confidence that we are on track to sustainably deliver the long-term growth targets we previously provided.

As I get into the results, I want to remind everyone that we have adopted ASC 606 on a modified retrospective basis. As previously discussed, because of the lack of prior year data under ASC 606, all references to year-over-year comparisons will be provided under ASC 605.

Core auto software revenue growth accelerated this quarter, growing 9%. Growth in core auto came primarily from Retail Solutions North America, which recorded double-digit growth, driven by the revenue from the ELEAD and Progressus acquisitions as well as strong performance in key application areas, including dot-cloud and service.

We were happy to see advertising outperform relative to our internal expectations. Though it was down 8%, we were encouraged by our ability to partner with our OEM customers to mitigate the revenue headwinds we've seen in the segment.

Our company profit was also a highlight as EBITDA and EPS grew 12% and 15%, respectively. We achieved this growth while investing in expanded implementation capacity and accelerated development effort for Drive Flex and strategic revenue initiatives in International, all while integrating and accelerating revenue growth in the ELEAD business.

Now on to the detailed results for the quarter. On an ASC 606 basis, total company revenues were $590 million. Core auto software revenues were $520 million. EBITDA was $222 million, resulting in a margin of 37.6%. Our effective tax rate was 24.1%, and diluted earnings per share was $0.98.

On an ASC 605 basis, total company revenues were $600 million, equivalent to 7% and 8% growth year-over-year on a reported and constant-currency basis, respectively. Core auto software revenues were $530 million, growing 9% and 10% on a reported and constant-currency basis, respectively.

Growth was driven by an increase in revenue per site in North America and International as well as recent acquisitions, both of which were partially offset by losses and declining revenue in selected nonrecurring revenue streams, such as consulting.

Total company EBITDA dollars grew 12% to $229 million, and margins expanded 180- basis points year-over-year to 38.1%. Margin expansion is a result of scale on revenue growth and the continued business transformation efforts, offset partially by changes in revenue mix caused by the recent acquisitions.

Our effective tax rate was 24.2% for the quarter. Diluted EPS was up 15% year-over-year to $1.02. Growth was driven by benefits from operating margin expansion and lower average share count due to buybacks, which were partially offset by increased interest expense.

Now turning to segment results. Under ASC 606, the Retail Solutions North America segment recorded $448 million in revenue. Pretax income was $191 million, resulting in a margin of 42.7%.

Under ASC 605, our Retail Solutions North America segment revenues were $445 million, growing 12% on both a reported and constant-currency basis. Subscription revenues were up 10%, driven by the ELEAD acquisition and high single-digit increases to revenues from 3-plus auto site groups, both of which were partially offset by low single-digit revenue declines from 1- to 2-site groups.

Transaction revenues declined 2%, largely in-line with the 1.4% decline in SAAR this quarter. Other revenues were up 45%, primarily due to the inclusion of revenue from recent acquisitions, partially offset by lower hardware, consulting and other revenues.

North America auto sites were down 32 sequentially to 8,888 sites or down 2% year-over-year. Declines in auto sites continue to be driven by loss activity within 1- to 2-site groups, partially offset by site growth in the 3-plus site segment.

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Pre-tax income was $185 million, and margins contracted 120- basis points to 41.5%. Margin contraction was caused by a shift in revenue mix from acquisitions, partially offset by benefits from operating leverage on subscription revenue growth and benefits from the business transformation plan.

Moving on to International. Under ASC 606, the segment recorded $72 million in revenue. Pretax income was $10 million, resulting in a margin of 13.5%.

Under ASC 605, International revenues were $85 million. Revenue declined 3% year-over-year on a reported basis and increased 1% on a constant-currency basis. Growth was driven primarily from increased revenue per site of 8%, offset by lower revenues related to the previously disclosed customer loss in China and lower one-time revenues.

International sites were down 26 sequentially to 13,167 sites or down 3% year-over-year. Declines in auto sites are attributable to the loss of the China customer and dealer consolidation. We will continue to experience year-over-year growth comparability headwinds in the third quarter. We remain confident that International growth will normalize to a trajectory in-line with what we've communicated previously for the segment.

Our backlog is promising, and we continue to execute on new revenue initiatives that will start to come online during the second half of this fiscal year.

Pretax income was $22 million as margins contracted 70- basis points to 26.4%. Margin contraction was caused by adverse changes in revenue mix and investments relating to strategic growth initiatives, partially offset by scale from the increased recurring revenues and benefits from the business transformation plan.

Now, Advertising North America results. On an ASC 606 basis, the segment recorded $71 million in revenue. Pretax income was $9 million, resulting in a margin of 13.2%. Under ASC 605, advertising revenue was $71 million, a decline of 8% year-over-year. This decline was driven by reduced advertising revenue across all 3 customer tiers.

Pretax income came in at $10 million as margins improved 50- basis points to 13.7%. Margin expansion was the result of benefits from the transformation plan, partially offset by a shift in revenue mix. As we look at budget levels for the second half of our fiscal year, we expect advertising revenue growth to perform in-line with the guidance we provided on the Q4 earnings call.

Our cash balance was $229 million, of which $182 million is held outside of the United States. First half free cash flow was $155 million, an increase of 47% year-over-year, primarily driven by increased earnings adjusted for non-cash items and improved working capital.

We returned $279 million to shareholders through a combination of dividends and share repurchases in the quarter and $760 million in calendar 2018. We ended the quarter at 3.1x net debt-to-adjusted EBITDA, slightly above our previously communicated range of 2.5 to 3x leverage ratio.

We expect to continue executing our capital return program with a goal of returning $750 million to $1 billion to shareholders through a combination of dividends and share buybacks in calendar year 2019 while staying within our range of 2.5 to 3x net debt-to-adjusted EBITDA.

Now I'll provide an update on our guidance for the fiscal year. As we are now 2 quarters of the way through the year and have been able to refine our ASC 606 forecast models, we will only be updating our 606 guidance going forward.

We are maintaining our revenue guidance range of $2.32 billion to $2.35 billion despite adverse foreign exchange impacts. We are also maintaining our previously provided EBITDA dollar range of $860 million to $895 million, and we expect to be at the higher-end of our EPS guidance range of $3.70 to $3.80.

Finally, we are maintaining our previous tax guidance range -- rate range of 25% to 26%. The details of our guidance ranges are included in today's press release and in the Investor Relations section of our website.

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In summary, we're pleased with the quarter, both in terms of financial performance and the progress we're making in our innovation pipeline and customer success efforts that serve as our foundation to achieving our long-term growth targets. As we head into the second half, we are confident in our ability to continue delivering strong financial performance as we ramp up investments in these key areas.

I'll now turn the call back over to the operator, and we'll be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Brian Essex with Morgan Stanley.

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

I guess I'll hit this one up front just because I've had so much inquiry on it over the past few days. But Brian and Joe, I'm sure you saw the speculation in the news last week regarding CDK and Cars.com. Is there any way you can address perhaps how that may or may not be an opportunity or perhaps provide a framework around your discipline for potential transactions, how you anticipate growing both organically and inorganically and what investors can expect with regard to that?

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Sure. I can start. This is Brian, and then I'll let Joe jump in. First, clearly, we can never comment directly on rumors and speculations. So on that specific one, we're just -- there's no -- we don't comment. But maybe we just talk about our general view on acquisitions. First, acquisitions really have to be clearly strategic, either that you're filling in gaps in your product portfolio or there's a long-term strategic shift in the industry, you believe that an acquisition can give you unique technology or leadership. And so that's the first thing is really understanding the strategy behind an acquisition. And then clearly, there has to be a, near term or relatively quickly, positive return on invested capital from a shareholder perspective. And just in the near term, we just completed last summer the ELEAD acquisition. It's going great as you saw from the earnings call. And we're really focused on doing a great job of integrating and growing that. We believe we've already demonstrated we can grow the ELEAD business quite a bit faster. So we're really focused on that, plus just the opportunities in our core auto software with Drive Flex and Fortellis, and that's where we're really focused right now.

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

What about the...

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Joe has something.

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

Yes. Brian, just what I would add is it's important for us to have a balanced capital return program. And then as you heard in my prepared remarks today, we reiterated $750 million to $1 billion in calendar 2019. And we look forward, as part of our year-end earnings call, for giving an update on how we think about that beyond calendar 2019, but having a balanced capital profile of returning capital to our shareholders while investing in the right strategic acquisitions that match the financial profile, particularly as we look at our core auto software business is important to us.

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

Got it. That's very helpful. And then maybe if you could touch on ELEAD real quick. How much growth in the period was organic versus inorganic? And maybe how you think about the contribution of ELEAD to the top-line?

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

Yes, thanks. So we're really excited. We were off to a very strong start with the ELEAD business significantly over-performing, particularly on the top-line versus our business case and what we had thought about in terms of new unit sales. When you look at the revenue, it becomes quite difficult to start to parse it out given the approach that we're taking, meaning we have stopped at this point selling our CRM. We are converting clients within our portfolio as well. And then there's other revenues between the 2 companies that now get eliminated. So quite frankly, we don't pull that out separately, and we're just pleased with having it into our portfolio and very focused on integrating it and building on the momentum on the strong sales quarter that team has had this quarter.

Operator

Our next question comes from Ian Zaffino with Oppenheimer.

Ian Alton Zaffino - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

I was kind of keen into one of the terms you used about at-risk dealerships. How are you defining basically who is at risk, who is not? How are you determining that? And if you were to kind of look at the whole portfolio, what portion is “at-risk”? And also, as far as your retention levels of those at-risk, where do you see that basically improving to? Because you mentioned that you've seen some pretty good improvement there.

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Sure. Again, this is Brian. I can start and then Joe can add input. I think the way we're looking at it, especially now, is every dealership that comes up for contract renewal or their contract is coming to completion, whether it was one that signed up for a 2-year contract 2 years ago or one that signed up for 5 years, 5 years ago or even ones that are going month to month. We look at each one of those now and one of the focus shifts we've done is every one of those is at risk to some extent, right? And we're there -- out there -- trying to earn their business. I think there are some that are -- we even started to identify that are uniquely at risk, maybe they're identified to us that they are considering other options or they are part of the 2-year contract effort that was put in place 2 years ago that are coming up. Those are relatively short-term contracts that locked-in those dealers 2 years ago but are now coming up. And so we're starting to identify where are most likely at-risk. But the way I have the organization really focusing right now is that every partner, every dealer is an at-risk dealer, and we need to treat them as such and really focus on better customer support and care. So that's how we're really looking at it right now. Anything else, Joe?

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

No I mean, all I would add is that the efforts and the push are really paying off with auto sites being where they're at, at the 8,888, and you start to look at next quarter year-over-year comparison, just gets much more reflective of the stability that we expect to see. And so when you look at the last 3 quarters and especially some of the lead indicators Brian discussed in his prepared remarks, we have more work to do, and we'll continue to do that. And we think we're making the right -- spending the right time with the right efforts to make a difference.

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Ian Alton Zaffino - *Oppenheimer & Co. Inc., Research Division - MD and Senior Analyst*

Okay. And then just a follow-up. On Fortellis, can you touch on that a little bit as far as what you're seeing as far as activity there, potential to bring more customers onto that platform? I know you had a couple of big contracts now with Lyft and I think SiriusXM as well. What else are you seeing as far as activity there? And what would be the pace of ramp that we should be expecting?

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Sure. Maybe I should spend a couple of minutes just explaining what Fortellis is and why some of the strategic shifts we've made in the last couple of months are important to it and then give you a little bit of where do we see it going from here. First, Fortellis, you can think of it as a -- simply a way for software, whether it's a layered application or a DMS, to work through an interchange that allows, through APIs, various levels of software to exchange data and operate then. So you can have a service layered app connecting to somebody's DMS and it's exchanging data about when was the car bought, who the owner is and what service has been done in the past and all of those kinds of things. There's a set of APIs that make a standard, very simple way for data to be exchanged across that. What we've really done in the last quarter or so is, one, made it agnostic in saying, whether it's our DMS or whether it's other people's DMS, whether it's our layered app or other layered apps, third-party layered apps, they're all going to be open and able to use Fortellis to interchange data. So it's truly meant to be an open platform. And then we made the initiation fee, whether you want to post an API to it because you have a layered app or a DMS or whether you want to use one of our APIs within your system. There's no charge for getting access to those APIs or producing those APIs onto the system. So we've lowered the cost barrier to entry fee into the Fortellis system. As you said, we've got some big partnerships going already. The whole idea of this is that all the dealers are dealing with -- the average dealer has up to 14 different pieces of software that they're using to operate their dealership. And right now, all those connections are point-to-point, right, and I have to make each one of those connections. Using an interchange like Fortellis, I'd make a connection one time, and any one of those other 14 pieces of software can access that data. And so it's much more efficient for everybody to push data around and have access to that data. And that's really the driver that people are using it for. Also, because it's open and agnostic, if I post -- if I'm a third-party layered app, if I post to it, it should work then no matter whose DMS I want to use as long as that DMS is connected to Fortellis. So again, it makes it much simpler and much more efficient for people to get their software out into the industry and to the marketplace. And so we look at this -- you saw we did a developer day, think of it like a hackathon at NADA. The attendance was great. People were actually posting. We had our -- both third parties in there. We had people from all over the world attending. We had some of our competitors attending. We signed up for the next one. The next one is in New York. It's already oversubscribed. So we're seeing a lot of interest in developers already signing up. We have about 170 users, if I - or 700 users, excuse me, using the system already. And so we think of this as it's going to take time to continue to grow this ecosystem. Think of it as an ecosystem we're building. And we need more and more DMSs to sign up to it. We need to post more and more of our own APIs internally so that people can have access to more and more of our connections, both on our layered apps and our DMS. And we need to get more and more independent software providers to really post their applications as well into this. But both between our partner programs and these developer days that we're doing, we think we're going to see quite a bit of growth over the next year. And I think this is going to take -- I don't see this as being something like Drive Flex that's going to dramatically change things in the next year or so. I look at this one as something that's 2, 3, 4 years in the making, but in the long-term could provide quite a bit of shift and change in how the dealership ecosystem operates. And so that's the way I'd like you to think about Fortellis, from that standpoint.

Operator

The next question comes from Rayna Kumar with Evercore ISI.

Rayna Kumar - *Evercore ISI Institutional Equities, Research Division - MD*

On January 25, you sent this letter to customers, highlighting acceleration of investments into Drive Flex and Fortellis and improvements in the service model, which is really echoing your commentary today. How will you balance these investments with margin expansion?

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Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Sure. This is Brian. I'll start. And then Joe, I think, especially is going to run and jump in on this one. One is you see that where the company is focused on growth. We've talked about retention of our dealerships better. So we believe we're already on a path to growth. So that growth can now fuel some level of spending, and we committed to grow revenue and earnings faster than our spending. But I just want to talk to you about kind of like how did we think about this. We're going to go spend more on Drive Flex and Fortellis. That's not hundreds and hundreds of engineers. Adding 10 or 20 engineers to a program like Drive Flex is enough to accelerate by several months or several quarters the rest of the build-out on Drive Flex. So we're talking about tens, building up to maybe a hundred or so engineers to really grow this business. This is not a massive buildup. And then when we talk about increasing our service hours and our service, changing the service hours doesn't necessarily mean we're going to get more calls and need more service or call people. What we need to do is shift the hours. So if we get X number of calls per month, but many of those calls would have been made on Saturday night when the dealership is trying to close that last deal, and our normal hours, we're out, that call waited until Monday morning. Now we're going to answer that call on Saturday night. It's the same number of calls. We're shifting -- going to be shifting people's hours more. So we're going to try and do that one without adding headcount, for example. So while this is just working smarter, not actually adding a ton, we do think we're going to need in order to -- what you're seeing is faster growth in ELEAD. We're going to build out Drive Flex faster. So things like install will add headcount, but that turns into revenue in a relatively quick basis. And so we are going to add that directly in correlation to the revenue growth that the install delivers as a result, and that's long-term revenue growth. And so we think those are good investments from that standpoint. So I think install is going to be the place where we'll probably add the most headcount, but again, that will be at the rate that's commensurate with the revenue growth due to the install.

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

Yes. And Rayna, what I would add is, as Brian said in his prepared remarks, it's really Brian's job, mine and the entire leadership team's job to strike that balance between making sure where we're being prudent in balancing, bringing on the investment with the revenue growth. And like Brian said, we've got the momentum at the moment, then we're going to lean into it. I think I would tell you that this can be variable quarter-to-quarter. And so I wouldn't sit here and say, boy, next quarter will be exactly this or that because there certainly is a lag for when the revenue comes on-line. The encouraging part about this business model is we have such visibility into our backlog and what we need to install and the revenue that's there. So it's an attractive opportunity. It's a good position to be in, and we will carefully balance it.

Rayna Kumar - *Evercore ISI Institutional Equities, Research Division - MD*

Great. That's very helpful detail. If you could just walk us through your plans to return to growth in advertising, how and when will you return to growth then? Where do you stand with General Motors?

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Sure. So look, let's start with the second part of that question first and just where do we stand with General Motors. Our relationship with General Motors continues to be quite good and both in advertising and Flex sites, we continue to have a great relationship and provide most of the services to General Motors in both cases. They did announce that on web services, they were going to open up to more suppliers. We welcome that. We are going to continue to provide great service. And we think, as we continue to make improvements in our web services, we'll continue to be a key player there as well. And then advertising is highly variable. And you saw last quarter, advertising was quite good. And we're continuing to be careful on the investment side in advertising and managing where we think advertising, long-term, is headed relative to our investments in that space.

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

Yes. As you look at the first part of your question, Rayna, what I would say is we are quite happy with how the quarter came out and the work that the advertising team is doing. And as you look at the second half, we certainly will continue to face some headwinds around the spending levels. Longer term, we're seeing progress right now where the team has made some investments to make the tech much more available to other OEMs,

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and we're seeing traction with that. We've got some of our first wins this quarter, particularly in the local market association space. And so our focus has been on diversification of the business and improving the trajectory. And I think we'll see -- you know, we'll continue to see progress over the longer-term on stability and return to growth is what we expect out of the team.

Rayna Kumar - *Evercore ISI Institutional Equities, Research Division - MD*

Great. One final question from me. Can you just walk us through your migration time-line for on-boarding customers to Drive Flex? What are the key milestones we should be looking out for?

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Sure. I can start this and see who else wants to jump in. With Drive Flex, we have -- you can kind of think of this is that what you have to do is go through OEM by OEM, and what you do is you first get OEM certification. What you're really doing is making sure that all the financial reporting out of a dealership is accurate and reliable back up to the OEMs, and you go by OEM. And so what we've got right now is GM on small like single-digit dealership levels, so 1, 2, 3 rooftops. We'll then go to the next OEM, which will be Ford, and at the same time, work our way GM into multi-large numbers. Drive Flex has the ability to do -- because it's a digital platform, web-based, we've actually run Drive Flex literally at 30,000 feet from an airplane using a tablet to make sure that it's truly something that is modern and can be used anywhere. We'll go to Ford and then also GM multi-stores and we can go to infinite number of stores. And we'll work our way through our target, and part of the acceleration dollars we said was done with the majority of the OEMs by the end of this year through certifications. We will be ramping during that time. We have 2 dealers up and operational right now. And we have, I think, about 40 orders on backlog right now already. And out of NADA, a lot of interest and we're putting together a plan now, and that's going to be a large part of our installs. I think you'll see conversions of Drive Flex taking -- if you take a look at the 9,000 dealers we have, it could take 3 or 4 years before we get through that number of dealers. But I think we'll start seeing an acceleration as we go through this calendar year. And by the back half of 2019 calendar, we should be at a run-rate that carries us through the rest of the time period, and that's probably going to be a couple hundred a quarter kind of run-rate.

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

Rayna, we've got to unfortunately keep moving along. Thank you for your questions.

Operator

Our next question comes from Matt Pfau with William Blair.

Matthew Charles Pfau - *William Blair & Company L.L.C., Research Division - Analyst*

I wanted to hit on the commentary earlier about ELEAD and the out-performance in the quarter. Maybe just some more detail in terms of where that out-performance came from. Has the reception within your own customer base been better than expected? Or I guess, are you seeing more traction with customers of competing DMS systems with ELEAD than perhaps you anticipated?

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

So I can start and then, again, Joe could jump in probably with more detail. I'd say it's relatively 50-50 and that we're seeing better growth in non-CDK DMS providers or sites, and we're seeing great growth in the CDK sites. Joe talked to you about we've stopped selling our CRM solution and selling the ELEAD solution. And so we're seeing really very strong growth on both sides, and I wouldn't say that one side is particularly stronger than the other. What you're seeing is larger sales force, larger company backing, people very confident that the technology can continue to be invested in and that you're also seeing us starting to link it to some of our other front-office applications that then -- one of the things we look at

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is this is a way -- an entry point -- because they had such good relationships and so many relationships on other DMSs, it's a great way for our layered apps to work into non-CDK DMSs as well as we link these together. So we look at this as a great opportunity. And we're out with the sales group saying, "Look, it should be an opportunity in both directions." CDK DMS and non-CDK DMS and not only the ELEAD, but tying some of our other layered apps together with the ELEAD application to allow us to sell even more into those other DMSs.

Matthew Charles Pfau - *William Blair & Company L.L.C., Research Division - Analyst*

Got it. And last one from me. It seems like in terms of the initial reception and pipeline for Drive Flex, pretty positive on that. When do you think we could start to -- or the impact from Drive Flex is going to be enough to turn the tide here with the 1- to 2-site dealers and make that perhaps become a neutral to positive contributor to site count?

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

So I'd tell you -- so NADA is probably a great example. We had 2 display stations or demo stations set up on Drive Flex. By the second day, we had to open up a third because there was so much interest and there was so big of a line behind those 2 demo stations just around Drive Flex. So the interest is definitely there. I think, again, it's going to take us a bit of time to get our ramp-up up in some of the other OEMs. I think as you go into the second half of this calendar year -- so it will be second half calendar year '19 or first half fiscal year '20 -- I think that's when you'll see Drive Flex start to materially shift the numbers, both in our sites and our revenue. And it just -- it's going to take a little bit of time like that to get momentum going in our installs and some of the other OEMs on the certification list.

Operator

Our next question comes from Gary Prestopino with Barrington Research.

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

Joe, could you just -- I was trying to write this down. Could you talk about what your growth in sites year-over-year was on the 2-plus point and what was the decline year-over-year on the 1- to 2-point?

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

Yes. So I don't think we disclosed the site count, so we do disclose the revenue. So the revenue on 3-plus locations grew high single digit, and the performance in the 1- to 2-segment declined to low single digits. And to the question we just got, I think you're starting to see -- so Drive Flex is a really important piece of it, but all of the other things that Brian had in his open letter to customers around customer service, around customer success and really the focus on retention and how much our sales teams, our account management teams are focused on, they're just doing a great job, and we're seeing those efforts really starting to pay off. And I think if you start to look at the second half, you'll continue to see more stability across the portfolio, and then Drive Flex should be additive to that as we start to get that rolled out.

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

Okay. And then with your -- with ELEAD, right, within your RSNA sites, your average revenue per site jumped pretty dramatically, so I would assume a lot of that is the impact of ELEAD. But in terms of your sites right now in North America, how many of them actually have a CRM application that you sell? I mean, I'm trying to get an idea of just how much this can proliferate through your base of sites in North America?

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

Yes. So several points I would touch on. You had talked about our revenue per site growth, 10% this quarter. I don't want you to walk away with this thinking that the majority of that is ELEAD. We're seeing really good sales progress from our core business, and I don't think we've talked a lot about that yet in the Q&A. But we're really proud of the work that the sales team and the installation team has done in products like Service Edge, has done in places like dot-cloud. Our sales continue to be strong, and that core base continues to contribute nicely to revenue per site. In addition, ELEAD is additive and is doing well on top of that. So you're right, there's multiple components to that. As we think about ELEAD, again, there's meaningful opportunity within our portfolio to penetrate it, and we've tried to be very thoughtful, though, I mean, there's just really strong demand within the 11,000 or so approximate dealerships that don't have our DMS. And we're seeing the momentum, as Brian said in his response, continue there as well as now add our base to it. So we're doing the best we can do to add implementation capacity with a very full backlog of robust pipeline, and I think there's opportunity for time to come as we go drive the penetration and integrate the business.

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

Okay. And then with Dealer Flex (sic) [Drive Flex], when that first came out, my understanding was it was for a smaller dealership, 1- to 2-point. It now seems like you're going to port that into the larger dealer space. I mean, what upgrades do you have to do on the functionality to get it into the multi-site operator versus the 1- to 2-space, if any?

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Sure. It's Drive Flex, by the way, and yes, it's because of the way it is architected it's a modern system with a modular configuration. You really don't have to make that many changes in order to get into the larger number of sites. It's mostly getting -- when you take a look at going into

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larger sites with more rooftops, they typically arm in one OEM. When you're talking about a dealership that may have 15 roof sites -- rooftops and they may have 4 or 5 different OEMs that they support with that, all requiring different types of reporting, and they want to aggregate that data together so they can see the portfolio of their businesses and understand them. So it's more about generating those

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modules that allow aggregation of the financials across several OEM systems. But again, that's because of the modular system that's simply an add-on piece of the software is the way to think about it. So it wasn't very hard for us to go and make it scalable to an infinite number of sites is the way you can think about it. It really is designed -- if you think about how a modern system works where there's drop-down menus, it's very intuitive, that's the way Drive Flex is architected, both on the user interface, but also how it's architected for the architected software, the software developer. So it didn't require a big investment on our part to do that.

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

Okay. And then lastly, you mentioned some on the strategy talking about data analytics, I think the third prong is strategy. Do you currently have a product out there that helps the dealers interpret their analytics or a data science team that is doing that for the dealers right now?

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Sure. In fact, one of the most kind of enthusiastic discussions we had at NADA was the first substantiation of the dealer dashboard. The dealer dashboard comes from that data set, and it's basically something we're going to start providing for free to dealers as part of our increased customer support. And it is basically the first level of analytics that lets them look at how they're using our software, how they're operating within their system. So for example, it's service lane, are there discrepancies in how fast customers are going through a service lane? And are those a result of how

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they're using our products? And can we provide more training? Or are there enhancements that are required? Or are there system issues itself? So the first substantiation of this analytics is already getting delivered to customers, and they were very excited to see that. We are building out an analytics team. We're just starting, I'd say, that effort. And you'll see more and more of those kinds of products. And we'll always provide a good, better, best type of support mechanism where there's a certain level that just comes with being a CDK customer. But we'll provide additional analytic levels all the way up to custom analytics for a reasonable fee to people as well. So that's kind of how we're thinking about this.

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

Thanks for your questions, Gary. We've got to move on to the next question.

Operator

Next question comes from Brian Essex with Morgan Stanley.

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

Yes, I just wanted to follow up on the dealer environment. Maybe if we could get a little bit of color of domestic versus international. And I know you know that there was some consolidation in international markets. How much visibility do you have in any of those markets? And maybe if you can give us a little bit of an understanding of the impact. You've called out China, but any other geographies specifically impacting that performance?

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

So I'm trying to make sure -- that's a pretty broad question, Brian, [I'm trying to make sure] I can answer it. I'd tell you that we're -- international, we're continuing to see, I'll call it, Greater Asia being the biggest growth opportunity. We still have good growth in Western and Eastern Europe as well. But I'd say if we're looking towards the future, we definitely see Asia, both China and the rest of Southeast Asia, as being the growth centers. I think in the U.S., yes, we continue to see some level of dealer consolidation occurring. It's kind of at a moderate level right now. But we know a lot of dealers. When I go out and talk to especially the large dealership groups, they are all looking constantly, I'd say, at are there good acquisitions out there and they're looking to consolidate further. How much insight, like do we have a model that says we expect this many over the next few -- like we don't try and model that. It's so dealer-specific. It's hard to do.

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

And as we've talked -- the only thing I would add is as we've talked on the past, we over-indexed our portfolio. 2/3 of it is in those larger dealer spaces, so we will continue to enjoy some of the benefit as that consolidation continues to happen.

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

Okay. And then how much visibility would you have? When you're modeling out your internal expectations, how much is based on your installed base? I guess, in terms of growth, how much is based on your installed base versus incremental dealer adds?

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

I'm not sure I follow the question. Could you say that again?

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

Well, I guess, how much visibility do you have in your pipeline? As you're internally modeling out your expectations for the year, if you have better performance in the quarter than we expected, but you held your guidance consistent with last quarter for the most part, what kind of visibility do you have into incremental dealer adds as opposed to incremental revenue based on penetration in the installed base?

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

Yes, we have good visibility, I want to be clear. I mean, we're very happy with the quarter. And it's -- we want to be very balanced around guidance. And so I thought, you're definitely seeing us hold our guidance. Again, that has advertising and it's got some FX stuff in it. So you do see strength in the top-line, and we're going to be very balanced. And there's a lot going on in the macroeconomic environment, and we'll continue -- we really look forward to updating you on future quarters on our performance. And yes, we're pleased with the revenue out-performance in the quarter, and we have good visibility into the second half. And so, yes.

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

And longer term, you heard Joe and I, actually the whole team here is committed to growth, right? So a real growth mindset in delivering these new products, innovating better customer support, we believe those things will deliver growth. And so I look more at that long-term. We continue to believe we'll continue to grow both top- and bottom-line.

Operator

We don't have any further questions at this time.

Brian M. Krzanich - *CDK Global, Inc. - President, CEO & Director*

Okay. I'd just like to say thanks, everybody, for joining us this morning. As I said at the onset of the call, I believe CDK is in a unique position to deliver to state-of-the-art software to the auto industry, which puts us in a great position to grow the business as we really capture that opportunity. And we entered the second half of the year focused on our phased strategy, encompassing our near- and long-term objectives. And we're confident that the plans and the initiatives we have in place will allow us to execute and deliver the growth we've committed to you.

And I look forward to speaking to you all again next quarter. And everybody, have a great day.

Operator

Ladies and gentlemen, this does conclude today's presentation. You may now disconnect, and have a wonderful day.

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