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CDK.OQ - Q1 2021 CDK Global Inc Earnings Call

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OVERVIEW:

Co. reported 1Q21 total revenues of $494m and non-GAAP adjusted diluted EPS of $0.82. Expects FY21 revenue to be $2.0-2.05b and EPS to be $3.10-3.40.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the First Quarter 2021 CDK Global Inc. Earnings Conference Call. (Operator Instructions) I would now like to hand the conference over to your speaker today, Julie Schlueter, Director of Investor Relations. Please go ahead, ma'am.

Julie Schlueter - *CDK Global, Inc. - Director of IR*

Thank you, and good afternoon. I'd like to welcome you to our first quarter fiscal '21 earnings call. Joining me today our CEO, Brian Krzanich; and CFO, Joe Tautges. Following their prepared remarks, we'll be taking questions.

Our earnings press release was issued after the close of the market today and is posted on our Investor Relations website at investor.cdkglobal.com, where this call is being simultaneously webcast. In addition, our website also includes an updated Excel schedule and a copy of our results presentation that we will be referencing during our prepared remarks.

Unless otherwise noted, all references to financial amounts during our call are on a non-GAAP adjusted basis. Reconciliations of adjusted amounts to the most directly comparable GAAP amounts are included in this afternoon's press release.

Please also note that all growth percentages refer to the year-over-year change for that period, unless otherwise specified.

I'd like to remind everyone that remarks made during this call may contain forward-looking statements. These statements involve risks and uncertainties, as further detailed in our filings with the SEC, which could cause actual results to differ materially from those mentioned in the forward-looking statements. With that, it is my pleasure to turn the call over to Brian.

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

Thanks, Julie, and welcome, everybody, to our call. This month marks my 2-year anniversary at the company. And what we've accomplished together in that time is literally outstanding. CDK started on this journey with a goal of making the complex business of automotive retailing easier, simpler and more connected.

We began with a massive shift in our relentless focus to be customer-centric and to work in partnership with our dealers and OEMs. The solid core of our flagship business solutions, the DMS and applications, has proven to be a key building block to dealer workflow efficiency and profitability. Combining our scale and our decades of automotive experience with our strong relationships with OEMs, third-party vendors and dealers has put CDK in a unique position to lead the industry through its current transformation, which is to connect all the various fragmented pieces of the ecosystem through a common platform. The benefits of a connected ecosystem to this industry are huge and disruptive. Just think about the increased value of your phone when apps were added. That's what we're doing. We're transforming the way the entire industry connects. These connections, centering on our industry-leading Fortellis platform, together with the vast amounts of information that flows through them, will enable a more seamless experience when buying or servicing a vehicle, which is what everyone wants. Our platform will also be a powerful foundational tool for the development and distribution of data-driven insights to help dealers, OEMs, partners and the entire industry.

And what I'd like to share today is that this is just the beginning. While we've already achieved a tremendous amount, I envision so many amazing opportunities for CDK to continue this process and leverage what we've built into the future. And for those of you who don't know me well, I'm a little bit of a data geek, so please indulge my deep dive into how I see us rapidly innovating and using more of our data-driven insights to provide what our customers need, both now and in the future.

After touching on our Q1 financial results, I'd like to provide some more details on our strategy for the continued strengthening of our core business and to offer our glimpse of where this journey of connecting the ecosystem and expanding our platform, integrations and insights can take our company and the industry. So let's start with the Q1 results, which outperformed all of our expectations.

Revenue of $494 million came in at nearly the same level as the first quarter of last year. This is an amazing accomplishment, especially since it included the ongoing accounting impact from the discounts we gave our dealers to support them during the height of the COVID shutdown. On an underlying basis, we're very pleased with the healthy growth of the core business, even more impressive is our bottom line reported earnings of $195 million, which increased 4% year-over-year and produced a 39.5% margin, all this while continuing to invest in our business.

Sales were off the chart during the quarter. In fact, this was our strongest first quarter on record for both total sales and our DMS sales. We've had 7 quarters in a row of year-over-year growth in North America auto sites, which were up by 9 and sequentially by 15, and we're making progress in the 1- to 2-site group with the lowest level of losses in 6 quarters. Adjacency sites were up 29 to their highest level on record. I'm extremely happy with these results as they underscore the intrinsic health of our core business and our dealer-centric model, which will allow us to continue our journey to accelerate growth well into the future.

So how did we achieve these great results at the same time the industry has been dealing with COVID? Let's start to answer that by taking a look at the CDK auto market industry charts in the presentation slides.

You'll see that we've added another chart this month. This one is on the volume of credit checks run through the system and the change over last year. Overall, the trends are showing that dealers are being very nimble about quickly evolving to a new way of operating and selling as they adjust to the impacts of COVID. This huge wave of digital transformation is about more than just being able to sell a car online. It's much bigger and is centered around dealers changing their internal operations to improve the entire consumer experience. Consumer behavior is shifting, and the dealers are increasingly realizing that the true competitive advantage lies in providing meaningful consumer experiences that are personalized, efficient and cohesive across all channels and interactions, whether online or in dealerships.

It's all of the touch points a dealer has with their customers from marketing and sales to service and maintenance. Creating a seamless and compelling customer experience matters now more than ever, especially given the increase in auto purchases by younger people. 45% are under 35 years old. This doesn't necessarily mean everything must be online. But it does mean that consumers don't want to spend 3 to 4 hours going through repetitive paperwork and endless negotiations. So dealers are using tools like our Connected Store and Sign Anywhere solutions to simplify the buying process. What makes our full suite of digital retailing products so powerful is that they help unify the end-to-end experience from online to showroom, and manage all this information across multiple sources to deliver a 360-degree view of the sales and provide a streamlined buying experience.

But the digital transformation extends beyond just selling. And dealers are looking across their entire enterprise and adjusting their operations to a more digital, connected and remote-everything environment from touchless payment systems to more cloud-based workflows. As one example, sales of our Doc Cloud solution were up over 50% this quarter. There are also many dealers today who still don't have the reliable high-speed networking connectivity they need. We've seen nearly a 200% increase in sales of our Cloud Connect service, which provides modern software-defined wide area networking for fast, continuous and dependable Internet access. And there's really so much more.

This is why we're continuing to invest today to capture more of this massive market to develop the solutions, connections and data-driven insights that dealers are demanding. This multiyear journey began with strengthening our core business, and we'd like to spend some time discussing where we are in the process and what to expect going forward.

I'll then share how we're leveraging this core to expand into opportunities beyond just what CDK has done historically, and provide a peek behind the curtain into my thoughts on what CDK will look like in 2022 and beyond.

As we continue to make meaningful progress on all fronts, our biggest focus these last 2 years has been on strengthening the core of this business, and that -- value that we bring to our dealership industry. We've made tremendous progress. We've enhanced and expanded our customer relationships, our NPS scores are positive and growing. And our focus on being a trusted adviser to dealers, OEMs and partners has led to numerous proof points that putting our customers first is the right strategy.

I'm also happy to report that we continue to make significant progress in our efforts to address customer concerns and transform our approach to the partner program by better allocating value across our solutions, all while working hard to absorb any additional headwinds.

Our internal business process modernization program, or what you'll hear me refer to as part of operational excellence, has moved well beyond just providing dealers with new and better invoices. It will be a complete redesign from dealer-facing quotes and installs to our internal accounting and payment systems, all centralized and streamlined for efficiency, and unified in a new cloud ERP.

Strengthening this part of the core has and will continue to improve dealer satisfaction and our internal operating efficiency.

We've also nearly completed the restructuring of our international business, and Joe will explain in more detail later. But already, our margins have begun to significantly improve in this area. Strengthening the core also means leading the industry in key strategic products.

Let me share some highlights. Our sales for Q1 were outstanding, both on a product count and an annualized recurring revenue basis. Part of our strengthening the core journey includes improving disclosures of our SaaS metrics, and we will be sharing more of this as we move forward. Our strong sales were led by key products such as CDK Service, the CRM, Doc Management and Cloud Connect. We continue to win back customers. For example, after our acquisition of ELEAD a large dealer group with 40-plus sites decided to switch their CRM to a competitive product. After trying to work with the competitor's desking tool functionality, they decided in September to move back to CDK. We successfully installed all sites within 30 days.

Our Connected Store product has seen tremendous growth, and we recently won a 30-plus site dealer for our premium version of Connected Store Platinum. We've made great strides in our adjacency business with a huge 70-plus site renewal of our second largest heavy equipment dealer, and a major upgrade for our second largest power sports dealer. Our truck sales were up in the quarter, and we had completed a massive installation project for a new 40-plus site truck dealership.

Our journey to strengthen the core also includes modernization of products and technology. We've made a great progress on several fronts. We've modernized our development by adopting DevOps to increase our release velocity. We're taking the API-first approach when developing new integrations between CDK and third-party applications. And we're building cloud-agnostic SaaS solutions with consistent architectural standards to improve security and resiliency.

We've increased the use of common components for a more unified user experience. We're also continuing to increase the number of products that we can sell to non-CDK DMS customers. Our modernization journey is well underway. We believe that, in addition to improving our products, it will, ultimately, reduce the time and cost to build and support these products.

Our CDK Drive DMS is part of our modernization efforts, and a lot of work has gone into enhancing the product. While much of the effort is behind the scenes and may not be obvious to users, we're improving workflows and interfaces that will help increase productivity and efficiency at the dealership. And for example, we're creating an embedded plug-in app to promote an OEM's reward program. The dealer can then enable the plug-in directly from the Fortellis marketplace and it will be embedded into the DMS. When a customer wants to use rewards points, an automatic prompt within the DMS provides the dealer with a modern user interface to log the transaction, which then flows seamlessly into the DMS and the customer award wins account. Using embedded apps along with our modernization efforts, make it possible for dealers of all sizes to benefit from modern user interfaces and improved workflows, all within our flagship Drive DMS.

We're also continuing to advance the adoption of our Drive Flex DMS with all the momentum we're seeing across our business, including the success we're having with Drive within the smaller dealer groups. We're being very diligent and patient in the rollout of Flex, which now has around 4 dozen live sites, including several independent dealers. This is a multiyear journey, and we're making great progress.

In summary, our core is healthy, and we'll continue to strengthen it in order to remain true partners with our customers to achieve operational excellence and to lead the industry with best-in-class solutions. Now that we have a solid base, we can shift further to the other critical focus of our journey, which is to leverage and expand our business. Transforming the way the industry connects and fuels innovation and commerce through open technology and allows us to build solutions based on data and insights. This is one of the most exciting parts for me personally. The way we and the industry can use data analytics and deploy artificial intelligence and machine learning will go well beyond what we've seen in the past. And by connecting the industry, we're opening up new avenues for incredible innovation and growth.

Because of our open approach, our vast experience in the dealership industry and the breadth of our ecosystem and the vast amount of data flowing through it, these new initiatives will drive continued growth now and fuel the longer-term vision we have to sustain that growth for the next decade and beyond. There are so many opportunities to provide dealers with enhanced solutions and to connect parties, both into and within the ecosystem, and to enable the flow of commerce.

So let me give you just one example. We're partnering with Global Payments to offer dealers our CDK One Pay solution, which is currently in development. This will modernize and significantly enhance the entire payment experience by providing dealers with more options such as virtual payments and contactless terminals, all integrated into our DMS via Fortellis.

By leveraging our scale, integrations and open platform, we'll be providing our dealers with new valuable benefits and believe it is a win-win for the dealers, their customers and CDK.

Several of our dealers, including 1 of our top 10 largest, saw all these benefits and signed up for the pilot program, and we expect to see substantial demand acceleration when we go forward to bring this to market early next calendar year. We're continuing to expand by using the same leverage to bring other parties from different verticals into the ecosystem. This really has so much untapped potential for our dealers, their customers, OEMs and CDK when you think about all the possibilities, use cases for the future, like security, connected cars or fleet management. And Fortellis is one of the key drivers to this strategy for expanded growth. Like other platforms, our initial strategy for establishing the Fortellis platform was to drive usage ahead of monetization, which we measure by tracking the number of transactions, which are exchanges of data.

As you can see on the slide, we've been seeing tremendous growth. You may recall that we reported total transactions for all of last year at around 12 million. I'm thrilled to report that this quarter alone, we did over 13.6 million transactions. And this is a clear signal that Fortellis is taking off, is being viewed by the industry as the industry platform in our vertical. And our goal is to reach over 100 million transactions this fiscal year.

So let's talk about data. We believe it's important for our industry to be able to move from data to decisions through the use of insights powered by machine learning algorithms. Dealers have high expectations about getting data-driven insights and solutions to enhance their success. And that's why we've taken an open approach and are committed to providing the strongest level of data governance and security. We truly feel this is the best way for our customers and partners to make smarter, data-driven decisions.

A part of our expansion strategy is leveraging our strong partnerships with OEMs to provide even more data-driven enhancements. For example, we take connected vehicle data from OEMs to provide dealers with insights on how to improve vehicle service offering. We recently added an OEM sponsored API that provides real-time inventory updates and allows dealers to leverage insights built from data they get through Fortellis.

We're also working on predictive insights using machine learning that will be embedded in CDK products. And for example, dealers will be able to use this information to alert a car owner to a needed repair before it becomes a problem. The very heart of our business is the incredible technology team that we've put together, and we continue to attract strong talent, including leading data scientists, engineers and architects from some of the best companies in the world. I have confidence that our entire team will enable our growth well into the future, and we'll continue to look at inorganic growth opportunities as well.

We're starting to see the return of bottom line earnings growth, which helps balance some of the investment spending. While we don't expect growth will always be on a straight line up and to the right, I feel confident in providing annual guidance at this time. And that we can fund our investments and grow revenue and earnings in the mid-single-digit range in fiscal year '21 and year '22, and beyond that, into 2023 and '24 expect earnings growth to further accelerate as the momentum picks up. Now I'm going to let Joe provide some details for our 2021 guidance and long-term outlook. But let me close with saying that I'm very happy with what we've accomplished. Our employees have really embraced the culture of growth and winning. I firmly believe that great employees make a great company, and I want to personally thank them all for their passion and hard work during this quarter. So I'll now turn it over to Joe for the results.

Joseph A. Tautges - *CDK Global, Inc. - COO & Interim CFO*

Thanks, Brian, and good afternoon to everyone. I'm happy to be able to share today the solid results we achieved during our first quarter. We navigated the crisis better than we thought, and I'm pleased with the underlying health of our core business and the margin expansion we achieved during the quarter. I see excellent momentum in delivering on our mission to accelerate the business, and I'll be sharing details on our Q1 results, our annual guidance and our latest thinking about FY '22 and beyond for the business.

As I reflect on the first quarter, there are 3 key strategic and financial themes that stand out: One, the rebound of our business from last quarter and the residual COVID impacts on revenue; two, our investments and expense actions and resulting earnings growth; and three, our annual guidance and future outlook.

Let me take a few minutes to walk through each of these points. First, we've recovered faster than expected, fueled by several actions we took during the last few quarters, including the progress we made in sales and installations, together with a strong rebound in our transactions business, which grew faster than SAAR during the quarter. When coupled with our relentless focus on being dealer centric, we've been able to improve customer sentiment resulting in lower losses and growing sites. Our balance sheet and liquidity are sound, and we were able to generate substantial cash flows during the quarter. Overall, we did quite well for the quarter and are in a good position to move forward with future growth opportunities.

You may recall last quarter, we provided some thoughts on potential Q1 COVID impacts, which included the amortization over time of the discounts and concessions we provided our dealers during the height of the shutdown, the reduced revenues due to delays in project work and installations, and the potential for lower volumes in the transaction business. As you can see, our transaction business bounced back and was not a headwind. This quarter, we booked the expected discount amortization and experienced the effects of previously delayed project work and installations due to COVID.

Overall, when you add up and adjust for these impacts in Q1, we were able to produce solid underlying revenue growth within our targeted range, and I'm pleased with how the core business performed. Second, regarding our investments and earnings, as Brian laid out, we are seeing the benefits from the investments we are making in our products and services, which are creating real value for the dealers, OEMs and partners. We've profitably grown the business, while, simultaneously, prudently managing our spending and pace of investments.

Our cost actions give us confidence that not only will we emerge from the crisis a significantly more cost-effective company, but we'll be able to reinvest the cost savings to help fuel future investments that will ultimately drive growth and drop the remainder to the bottom line.

And finally, third, the sharp acceleration from last quarter, which exceeded our internal plans, gives us the level of confidence needed to provide annual guidance. Our resilient financial results offer clear evidence of the stability of our business model with its high level of recurring revenue and expansion opportunities. While we remain mindful of the uncertainties about COVID, we feel great about our results for the quarter and are well positioned to achieve strong full year financial performance.

So let me take you through some of the financial details in the quarter, starting with revenue. I'm pleased to report total revenues of $494 million, including $414 million from North America and $80 million from International. This represents a 10% increase over last quarter and is equal to revenue generated in Q1 of last year. This was higher than we expected, as I mentioned, when adjusting for the impacts from COVID produced healthy underlying growth.

Looking at the drivers of growth by region. New business generation in North America came from 9 new auto sites and 29 new adjacency sites over Q1 of last year. This is now 7 quarters in a row with year-over-year site growth in North America auto. We saw further strengthening in total recurring revenue from the 3-plus site dealer group, offsetting a slight decline from the 1- to 2-site dealer group.

Auto revenue per site was up over 2%, driven by gains from key layered applications with strong growth in CDK Service, CRM and Document Management. The adjacency business generated robust cycle in the heavy equipment space as we continue to add new agricultural dealerships. Adjacency revenue per site was up nearly 4% for the quarter. Overall, North American subscription revenue was down 3%, with strong underlying growth more than offset by the impacts of COVID as well as a onetime revenue adjustment in our adjacency business.

Transaction revenues of $44 million came in much better than we expected and were up 3% year-over-year and almost 30% from last quarter, much better than the 10% downturn in SAAR. The primary driver was increase in overall transaction volume.

North America other revenue was $44 million, up 9% due to sizable gains in hardware, including our Cloud Connect networking service and Document Solutions. Overall, we're pleased with North America revenues of $414 million, which were up 10% over last quarter and down slightly by 1% year-over-year.

Our International revenues performed very well and were up 4% or 1% on a constant currency basis. Subscription revenue grew 6% and continues to see healthy performance from increases in revenue per site of 4%, offset by continued site losses, primarily from the expected site declines in China.

Now turning to earnings. First quarter EBITDA of $195 million was up 4% year-over-year, with a margin of 39.5%. Our outperformance in the quarter was primarily driven by our tight management of operating and travel expenses, plus the benefits of restructuring efforts in International, which are nearly complete and produced a better-than-expected margin gains, offset by our strategic investments.

At a segment level, North America pretax earnings were $161 million for the quarter, with a margin of 38.9%. International pretax earnings were $26.2 million for the quarter, with a margin of 32.8%, which was ahead of our targeted 30% plan.

Our effective tax rate was 26% for the quarter, up from 25% in the same period last year. Quarterly diluted earnings per share were $0.82, up 4%.

With respect to our balance sheet and liquidity position, cash was $281 million, of which $227 million was held outside of the United States. Access to liquidity remains strong with more than $700 million available on our revolving credit facility. Net debt to adjusted EBITDA was 3.2x.

For the quarter, we delivered improved free cash flow of $80 million. During the quarter, we paid out $18.2 million in cash dividends to shareholders. We expect to continue our normal quarterly dividend payments. I'm pleased to report that we reached a settlement in another of our antitrust lawsuits in October, which now brings the total to 4 settled cases. We expect payment under this new settlement to be incurred during our fiscal second quarter.

We're happy to be able to put another lawsuit behind us and continue our focus on the future.

Moving on to guidance. Given the resiliency we've seen in our business model and the momentum this quarter, we're excited to share with you our fiscal '21 annual guidance. We expect total revenues for fiscal year 2021 to be $2 billion to $2.05 billion, EBITDA to be $760 million to $800 million, and EPS to be $3.10 to $3.40.

While our performance in Q1 leaves us optimistic about the future, we remain mindful of how the pandemic may impact our customers and our business going forward. As a reminder, certain COVID-related impacts are known, such as the amortization of past discounts, while others cannot be predicted at this time. Overall, our guidance includes impacts for the full year of fiscal 2021 that are approximately equal to those recognized in late 2020.

Despite COVID, our priorities are clear as we look out over the next year and beyond. We are pleased that this guidance allows us to continue to invest in the business, and are quite focused on prioritizing and sequencing our strategic investments to better position our company for continued revenue and earnings growth.

In addition, we remain committed to our efforts to transition away from certain fees as we transform the partner program and any timing mismatches have been factored into our forecast. We'll manage our business to deliver financial results that will see a strong foundation for growth and profitability for this year and beyond.

Now we'd like to share some thoughts with you about our views of fiscal year '22 and beyond. Given the momentum we are seeing in our core business, we would expect a good level of revenue growth and productivity, which will help self-fund the increased investments we make in the business. As such, we would expect as we head into fiscal year '22, that our revenue and EBITDA growth would be in the mid-single-digit range. Our longer-term outlook for fiscal year '23 and beyond remains, as previously stated, at mid-single-digit revenue growth and EBITDA growth in the high-single-digit or low-double-digit range.

We're on a multiyear journey with lots of opportunities, and we're not slowing down. We're staying on the offerings and extending our leadership position. I'm energized by our incredible potential and bright future. I'm very proud of our team's ability to successfully lead through change and would like to thank our employees, our customers, our partners and shareholders for their continued support.

Thanks, and now we'll open it up for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Josh Baer of Morgan Stanley.

Joshua Phillip Baer - *Morgan Stanley, Research Division - Equity Analyst*

Great. Congrats on a nice quarter. I had one on Fortellis and one quick one on capital. On Fortellis, just wondering with the target to reach over 100 million transactions, if you could just dig in a little bit there. What's driving that growth? Is it more use cases, more dealer sites using Fortellis? And any way to think about revenue potential from Fortellis?

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

Sure. This is Brian. I can start, and then Joe is more than welcome to. So remember Fortellis is this whole platform that has internal uses, external uses, external uses by our partners, and there are third-party uses where it's third-party direct to a dealer and, in some cases, that doesn't necessarily involve a CDK piece of SaaS software. So there are all of those. The majority of the growth is a combination of our own internal usage and external third parties -- the biggest one to date right now is around our repair order, which is -- supports the service applications. Those are the 2 big growth areas, but we're starting to see opportunities and growth almost across the board against every application.

So I think to get to the 100 million, it's really going to have to be driven even more so by external, both third-party direct to dealer and our own connections out to third parties and into dealers.

Joshua Phillip Baer - *Morgan Stanley, Research Division - Equity Analyst*

Great. And if you could review your capital allocation strategy that would be great. I know you mentioned inorganic growth in your remarks, obviously, the dividend. Also wondering about where potential reinstatement of the share repurchase program might fit in just given your strong cash flow generation?

Joseph A. Tautges - *CDK Global, Inc. - COO & Interim CFO*

Yes, thanks for the question, Josh. We're quite pleased with free cash flow in the first quarter and the momentum that we see. Right now, our top priority continues to be to delever and deploy capital there while maintaining the dividend. You did hear us talk a bit about inorganic. And from our perspective, where there is a very attractive opportunity where we can look at an asset that can fit into our workflow or be very synergistic with our base, we won't be afraid to capitalize on those opportunities. That said, our key priority right now remains to delever, continue to generate the free cash flow. And then there's so many opportunities to accelerate growth in the business and really deploy capital where it makes sense around those inorganic opportunities. But we'll be very thoughtful as we balance those priorities.

Operator

And our next question comes from Ian Zaffino of Oppenheimer.

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

Very good quarter and thanks for all the guidance and color. Very helpful. Thank you. I guess the question would be on the dealer count and maybe at the smaller end, how are your discussions surrounding Drive Flex going. I think there was a little concern that maybe Drive Flex would cannibalize the core business. Have you seen that? Or are you seeing actually higher revenues per site as you sort of move to Drive Flex? And any other type of color you could give there would be really helpful. Then I have a follow-up.

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

Sure. I can start. And then I'm sure Joe will have some thoughts on this, too. To me, Drive Flex is the first step in a modernization of the two things on our software structure or architecture. One is around some of the architecture itself going to micro services, updating the data base from a Pick's database to a more modern database and then updating the user interface. So having what, I think, we all become accustomed to in applications where you have drop-down menus and auto fill and things like that. And that's really what Flex is. It's a modernization of all of this.

And what we've been really focused on is a couple of things over the last couple of quarters. And that is: One, yes, we have a Drive Flex. It's right now targeted more to the smaller dealer group. But when we really took a look at it, we said, "Gosh, these same features and these same efforts really need to go into the full suite of Drive." And what we may want to do is bring some of that core down into Flex. So what you're going to see, if I project out 3 or 4 years, as you're going to see: One, let's call it, Flex architecture. It's going to have a common UI. It's going to have a common set of modern methodologies of the database and the -- how the software is written with micro services and structure and all. And you're going to have like a Flex "Super Lite" that goes into independents. And that one has a lot of the features removed and is very simplified and that has one price point. You'll have a Flex "Lite" for the smaller dealers and then you'll have a Flex "Enterprise" for the larger dealers. And those come with different features, different capability. And what Fortellis and all of the work we're doing around data allows is to really help us differentiate. An independent doesn't need much insight data, doesn't need a lot of those analytics applied. A smaller dealer may need some, but not a lot of complex inventory management.

And the enterprise guys, they want to trade between their dealerships. They want to trade dealer to dealer. They want to have all kinds of insights about the overall market in their area, and we'll provide a lot of those capabilities and that will allow that differentiated price, and, we believe, prevent any degradation of our various price points.

To answer your question more bluntly, are we seeing price erosion from our current? No. It's really scaled to the application. So I know -- we already can structure Flex such that we de-feature it when we sell it to the independents and they get a different price point, but it's got a much different feature set, say, what the larger dealerships are doing. And we've done a mix of those to make sure that we really understand as well.

Joseph A. Tautges - *CDK Global, Inc. - COO & Interim CFO*

If I -- and then if I add to what Brian was just sharing, I got to tell you, the other part, you heard a lot in Brian's section around things that we're doing even in our core base Drive product today and the improvement in Service and the investments that we've made. And that is resonating and making a difference. As you start to look at site performance, this is, I think, the first quarter in a very long time where we saw sequential improvement in the 1 to 2 number of sites. And it's just a combination of the focus on a multipronged approach the way Brian just laid it out. So we're -- and you've heard in my prepared remarks, a slight decline in revenue in 1 to 2 the trend gets better each quarter And I think we're certainly on the right path and very thoughtful about the impacts as we go invest as well as drive the current business.

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

Okay. Great. And then if I could just sneak in 1 or 2 more is on the outlook, when you talk about the acceleration of EBITDA growth, you said, in the near term, you're going to have offsets to the investment. So does that mean the acceleration of EBITDA in 2023 and beyond? Is that actually from the investments you're now making purely? So are you going to see like this nice ramp because of all the investments you're making now? That's the first question.

And then maybe -- I don't know if this is better for Brian or Joe. On the International side, remind us of what the rationale of that business is inside CDK as a broader entity? Because I know you got rid of digital marketing, and I just wanted to make sure that, as I'm looking at the portfolio inside the company, it all sort of works together or does it work together? Or how we should think about that?

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

Sure. So that was a bit of a complex question, or a set of questions, but let me try and start, and I'm sure Joe can add some additional color.

When we think of the EBITDA growth, and where we're headed? We think about, "Yes, we're making investments?" And if you remember, there's 2 sets of investments we're making right now, actually 3, and they have varying -- whether it goes into our cash position or whether it's capitalized and things like that, but not going to go to that. But we're really making investments in our customer support. We're making investments in our -- and that comes in the form of headcount and actual people to spend time more with their customers, not just selling, but really working with them to make sure they understand our software and are getting the right levels of support.

The next thing is around the modernization of the ERP system, where we've talked about that. You'll often hear it called Project Aurora. That's really critical and that goes from top to bottom. It literally goes from how we've part numbered our offerings to how we quote an offering to a customer all the way through to the accounting, and it should streamline that whole system. And it streamlines both external and internal. So it was really funded through -- by the way, I am a firm believer and everything gets done through an NPV and everything has to have a positive NPV. So that project was done through a positive NPV analysis that has both external and internal efficiencies that will reduce the cost of producing either a quote or a bill. And that will result, once implemented in about a year or so, in EBITDA improvement just from that.

And then you move into the other side that we're doing the work around the technology itself. When you start to modernize this thing, right now, it's not API-driven. It's all direct connections. It's not micro services. So every time you try and go fix something, you have to find everywhere the connection is and the database is old and convoluted. And oftentimes, things that should actually be outside of the database are in the database and got to figure that out and things break. And so we believe that as we modernize that, which has about 2 more years of work left, you get a large efficiency in our ability to sustain the products, not only sustain them, but also improve what we're delivering. So we can actually get additional opportunities to upsell into the next levels of product. Those 2 things will drive additional EBITDA growth from those objects.

So that's why Joe and I said, "Look, in the near term, we think we can continue to drive the margins that we have, and we can continue to grow our margins at this rate, mid- to low-single-digits." But in roughly 2-ish years, we think we can accelerate those because we finished our internal work on the customer improvements, and we'll have gotten to the next level of the technology improvements. And those should allow us to accelerate. And again, all of this is done, we do nothing without NPV. I was trained on NPV, and we do everything with an NPV.

And your last question -- your last question was around International. Joe, do you want to comment on this first?

Joseph A. Tautges - *CDK Global, Inc. - COO & Interim CFO*

Yes. If I could just add 1 thing to what you just said. The other part, just to give you and the team some credit. So Brian, Scott Herbers, the Head of our sales team and his leadership team. We give this guidance with the confidence with the sales quarter we've had, the revenue component is so critical here. And when you look at the backlog, whether it's around DMS sites around our Service application, around our CRM application, having the strong sales that we did to finish our last fiscal year, having the record Q1 that we've had, gives us enough backlog visibility to also have confidence around the revenue and the gross margin and that contributing. I just want to make sure we don't miss the piece and some of the work that the team has done there as well. Sorry, Brian, go ahead.

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

No. I was just going to answer the second part of the question, which was around International and how does strategically it makes sense. I mean, first, the OEMs are roughly the same as you go from international to domestic North America. So our relationships, our ability to integrate data, to integrate the whole sales process with them. The dealer model is different. And currently, the software model is different in International. But that doesn't -- the dealer model will always be different. But we believe there's a lot of synergy. Things like Fortellis, we're already looking at how to remodel Fortellis, out into the International space, as an example. So the OEM and the ability to share our common software as we move forward should allow us to get more and more efficient. You saw us make the improvements this quarter, as we talked about last quarter, on the efficiencies, and we saw the margins improve. Those will continue as we move forward in this space.

So we think it's a profitable business, a good business, a growing business, and one that we can share more and more as we become smarter.

Operator

And our next question comes from Gary Prestopino of Barrington Research.

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

As of the end of the quarter, I mean, at the end of Q4, your backlog of Drive Flex was about 100 sites. Has that grown at all?

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

Yes, it continues to grow. We're -- I'll just -- again, I wanted to comment back from what we said before. We've actually slowed down our implementation of Flex. And it's not because there's issues or we're struggling or we're worried about any kind of erosion on price. It's because what we've actually seen is this opportunity to build it out much broader and to bring a lot of the issues of Drive in. You're going to see one of the big projects, if you remember from the technology work we're doing is around our Service applications. So you're going to see a lot of the user interface, the data set, all of that going into our Service application as well.

So we've actually grown the complexity and the scope of Flex. And so we don't want to go out and just start massively deploying it versus saying, "Okay, let's continue the development. We've got the right number of people on it to continue testing it." We will continue to implement it at a nice comfortable rate, but more importantly, let's focus on how do we get this across our -- all of our products at a rapid pace.

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

Okay. And then given what's happened with the pandemic and your dealer base. I mean what are some of the conversations you're having with them? I guess, what are some of their most requested products that they may want to have now given that we're moving more into a digital selling mode versus high touch?

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

Yes. No. In fact, there's an interesting piece of data in our prepared remarks, where one of the fastest-growing segments now are people under 35 years of age that are buying cars, right? So I think with the pandemic, we're seeing a couple of trends. One, yes, it's a bit more -- it's a lot more digital in process. We'll talk about that in a second. But also even the demographics are shifting, right?

And so you've got to have a more -- those people have grown up on iPhones, have grown up in the Internet environment and they need a different user interface, a different ease of use. And they want a lot of flexibility. So what we're seeing is, yes, you've got to have a digital application. You've got to be able to be penny perfect, and that's one of the real complexities of this is getting it such that you can get all of the OEMs incentives and you can get all of the local incentives, attacks and everything else, such that a person can go through the process and what dealers want is the flexibility. And the consumer wants it, too, to drop down at any point along the continuum of the purchasing. Some people are going to want to go all the way to the last thing that you have to -- with a wet signature or a pen. Every state has different laws. I'm very familiar with California. They require 2 forms to be signed in person.

So the dealers want, for example, the ability of a person to drop down at any point along a purchasing journey and to be able to be penny perfect and still execute that transaction. So some people want to go out, price cars, pick one, select one, go into the dealer, do a test drive really quick and buy. Some people don't want to ever touch the car, want it delivered to their driveway and they just want to sign the 2 pieces of paper and have the guy leave. And we need to be able to provide a solution that can go all along that continuum and provide ideas and options, for example, if they want to lease it or if they want to finance it, or they want to pay cash, how does that change? What are their options, all of those things.

So our Connected Store product you saw us at the beginning of the pandemic actually give them roughly 2 years of free service. We've had a large. We've made the basic one free, but actually, a number of people who have signed up for the Platinum level has been quite high. That's been one of our good growing pieces of software during the last 2 quarters. So we are continuing to grow in that digital space. But they want this flexibility to be able to move along that continuum of the purchase.

Operator

And our next question comes from Matt Pfau of William Blair.

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

So first, I wanted to ask on the North America DMS site count, nice sequential increase there, especially given the current environment. Maybe can you just give us a little bit more detail on what drove this? Was it more of a factor of improvement in churn in the 1- to 2-site segment? Or are you also seeing better new sales? And is Drive Flex a role in this at all?

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

Go ahead, Joe. You can start. I've been talking too much.

Joseph A. Tautges - *CDK Global, Inc. - COO & Interim CFO*

Yes. No. So I think it's a combination of factors. We saw another good quarter of implementations and new business coming in. Secondly, we saw certainly a lower level of losses as well. And we've seen it across both portfolios, both the 1 to 2 as well as 3-plus site segments sequentially showed improvement. And like we've been talking about throughout the call, just the customer sentiment, our customer-centric model and how we're approaching things is resonating and performing well. So I think we continue to see momentum there. We continue to see it in our win rates. And that's really what has produced the benefits sequentially.

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

Got it. And If we look at the subscription revenue growth for North America, obviously, the discounts hit that in the quarter. Maybe I missed it, but did you quantify those at all? And what would that growth rate look like absent some of those discounts impacting the growth?

Joseph A. Tautges - *CDK Global, Inc. - COO & Interim CFO*

Yes. We try to do our best. We've had a lot of discussion about that. And the best I would tell you is there's so many moving pieces with the discounts and what our install rate was pre-pandemic and then there was some disruption in Q4 with the pandemic. So what I would tell you is, everything we pull apart, we've shared before that the business should expect growth between 4% to 6%. And I would tell you what we see in the underlying performance of growth is very much in line with that. So when we pull apart -- all the piece parts. We see growth that is in line with that. And we see after we come through our fourth quarter this fiscal year and really enter into next fiscal year, the comps will be quite clean, and you'll start to see much more of that easily. But for sure, it's a bit impacted at the moment.

Operator

And our next question comes from Charles Nabhan of Wells Fargo.

Charles Joseph Nabhan - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

I know it's not a one-to-one correlation, but I was wondering if you could talk about the factors that led to the outperformance of transaction revenue relative to SAAR? And how we should think about that relationship going forward?

Joseph A. Tautges - *CDK Global, Inc. - COO & Interim CFO*

Yes, sure. So listen, we were really pleased with how the transactional businesses performed in the quarter. When you look at it, and just as a reminder, the largest portion of transactions that we have is our CVR business, which is a vehicle registration business is -- and that's only in certain states. So that volume will be impacted based on how that state is performing. And credit check is our other business as well with transactions. And what I would say is we -- there are several factors at play around why we've seen it outperform. Some of it is our sites are growing. And so as the sites grow and that will outperform. And secondly, we over-indexed to the larger dealer population. And we've seen a differentiation of performance amongst the groups. And we've seen good execution. I think the teams have done a really nice job across those businesses. And so I think there's a number of factors where we've seen some positivity. Brian, I don't know if there's anything you'd add?

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

No, I think you captured it right. There's -- a certain amount of this is just, like you said, indexing to large dealerships or groups and the states that we happen to play a large percentage of this is in California, for example, of our CVR business. And so -- and in the Western states. So I mean, that's just kind of where the business is -- has been strong of late. So it's just that.

Charles Joseph Nabhan - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

My second question is on the sales momentum during the quarter. And firstly, I was wondering the degree to which the sales momentum was driven by some of the discounts you had offered back in the spring, specifically around Connected Store, where a discount may have expired and a customer like the product and started paying? And secondly, on the sales momentum, just wanted to get a sense for when we could see that revenue start impacting revenue -- those sales start impacting revenue, the degree to which it's baked into the guidance for '21?

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

Sure. So I'd tell you, I mean, very little, if any, of the sales momentum is driven to discounts. If you remember, Connected Store, for example, we did for 2 years. So it's -- they've got through the end of next year. The month of software we gave away was only for existing customers. We probably see some people who tried some of our layered applications and decided to keep those even post the discount. So there's -- I don't want to say it's 0, but it's minimal.

Most of this growth is more focused. I spend a lot of time -- I'm even traveling now visiting customers and we're spending a lot of time on Zoom with customers or phone calls. It's more around, "Hey, I hear the company", -- one of the most common lines I hear is, "I hear the company is really changing. I really like what I hear." And "so-and-so is converted over during last year. And I think I'd like to have a discussion with you guys." I spend a lot of time with them talking about the service and level of commitment we will make as a company. They usually get my personal cell phone number and they can call 24/7. And some of them do, and I think that gets out there. So it's much more around our service and our product. They also are hearing -- putting from Mahesh, our CTO out there a lot to these guys. They're hearing the product road maps. They see where our products are going, and they really like it. It aligns well with where they're taking the business. So I'd tell you, it's much more that and not really the discounts.

And there was a second part to your question that I'd like blanked on now. So can you repeat?

Charles Joseph Nabhan - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

I think you actually -- I was trying -- I wanted to get some color around the impact this quarter's sales will have on revenue?

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

It depends a bit on their -- what their schedule is. A lot of times they'll contract with us. They may have a 6 months left with their current provider or they may have only 6 weeks left with their current provider. It's rarely goes much beyond that. So it's usually within 1 or 2 quarters that we're in there doing the install.

Joseph A. Tautges - *CDK Global, Inc. - COO & Interim CFO*

Yes. And Chuck, what I would add to what Brian said is when the in-year impact, given that we're already 4 months at this point into the year is smaller, the impact is and that is -- that has been taken into consideration in our guidance. The bigger impact is as we look into next fiscal year, and that's really the basis for which we've offered a bit more color and indication into next year's performance given we see the full year impact of those implementations going live.

Operator

And our last question will come from Rayna Kumar of Evercore.

Roberto Suarez - *Evercore ISI Institutional Equities, Research Division - MD*

This is actually Roberto Suarez on behalf of Rayna Kumar. I was wondering at the beginning of the calendar year, Tekion funded by General Motors launched a new DMS. Are you starting to run into them when bidding for new deals? Are you seeing any new competitive entrants at the high end of the market? And then I have a follow-up.

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

I mean just -- any time we go in and bid against, I think, existing dealership, we see competitors. We see Tekion occasionally, I'll be honest, not often. Joe talked to you about how we tend to be weighted more to the large enterprise class dealers. But we see them out there. They're a competitor like several of the others, nothing unique. And we take them all serious, by the way. I mean. I don't mean to be that in a way of that we don't consider everyone a threat, and we work hard to win every single customer. I don't care what size they are. And we'll beat our competition through our technology and our customer support.

Roberto Suarez - *Evercore ISI Institutional Equities, Research Division - MD*

Got it. And then how are current trends in new and used car sales affecting the health of your U.S. dealers and your revenue by extension?

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

Yes. Well, part of why we showed you all of those graphs in here is to give you some insight into exactly what's going on in the dealer group. And remember, we have just under 50% of the franchise dealers that we're reporting on. And we added additionally like the financial transactions that are going through our software as well to turn and give you guys insight into exactly how is the business looking.

I'd tell you that almost every dealer I talk to right now will tell you, "Sales are pretty good. I could use more inventory, especially of the hot vehicles. And if I had more of those, then I could do even more." And I think you heard that on the AutoNation earnings call. They talked about -- most of the big enterprise guys have talked about the same thing. So we're seeing sales recover pretty nicely in all of this. And we're seeing the OEMs pick up the inventory capability and improving that as well. And we think -- I think everybody thinks that as we go through the remainder of this calendar year, the inventory issues will continue to improve. And right now, we feel sales will continue to improve as well. And what we're seeing, and that's -- again, we tried to give you some more insight into this, right? The fastest -- one of the fastest-growing segments is 35 and under. And what you're seeing is a lot of people -- I was talking to somebody today, and they're like, "Yes, I used to do the Ubers and Lyfts and kind of those transactional rides, and I'm more comfortable having my own car now." And you see that plus people moving out of the concentrated cities into the suburbs. All of those demographic factors are, I think, positive trends for this industry. And I think will continue at least for some time, at least another year or so those trends will continue to grow, in my opinion.

Operator

And ladies and gentlemen, this does conclude our question-and-answer session. I would now like to turn the call back over to Brian Krzanich for any closing remarks.

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

Yes. I'd just like to thank everybody for coming today. Joe and I really spent a lot of time with the team trying to provide more and new insight and a forecast into the mid- and long-term future for CDK, which, I hope, really helps you guys as analysts. And then just thanking the employees, right? Great companies are built on great employees, not on anything else. And so I think they've done a wonderful job with the quarter, and I'd just like to thank them. And thank you all, again, and we'll see you next quarter. Bye now.

Operator

This concludes our call, and you may now disconnect.
