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CDK.OQ - Q2 2021 CDK Global Inc Earnings Call

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OVERVIEW:

Co. reported 2Q21 total revenue of \$406m and non-GAAP adjusted diluted EPS of \$0.59. Expects FY21 revenue to be \$1.66-1.71b and non-GAAP adjusted diluted EPS to be \$2.45-2.75.

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q2 2021 CDK Global, Inc. Earnings Conference Call. (Operator Instructions) And please be advised that today's conference is being recorded. (Operator Instructions)

I'd now like to hand the conference over to your speaker today, Julie Schlueter, Director of Investor Relations. Please go ahead.

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

Thank you, and good afternoon. I'd like to welcome you to our second quarter fiscal '21 earnings call. Joining me on today's call are CEO, Brian Krzanich; Chief Operating Officer, Joe Tautges; and our new CFO, Eric Guerin. 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 investors.cdkglobal.com, where this call is being simultaneously webcast. In addition, our website also includes an updated Excel schedule of supplemental financial information and a copy of our results presentation that we will be referencing during our prepared remarks.

Throughout today's call, we will be discussing our continuing operations only, which do not include our International business. Given the announced sale on November 30, 2020, the International business results are now presented as discontinued operations, and we will no longer be reporting segment information. Prior period amounts have been reclassified accordingly.

Within the press release, we have provided the last 5 quarters of historical financial data on a revised continuing operations only basis.

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 would 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

Thank you, Julie, and thank you, everyone, for joining us today.

Before I jump into the quarter and my thoughts around the company more broadly, I'd like to take a moment and welcome a new member of the management team, Eric Guerin, our new CFO. Eric joined our team in mid-January and brings a perfect mix of financial expertise and business acumen that we were looking for in a CFO. He's helped improve the finance operations of large complex organizations with hundreds of people and through numerous acquisitions. He's got the right skill set and experience to bring together our many internal processes and systems to get them running like a well-oiled machine, so we can move quicker and seamlessly on our growth journey. Eric's a great fit with our values and culture, and I'm excited to welcome him to the team.

Now let's move on to the quarter. We had a really exciting quarter as we continue to make incredible progress on our journey for accelerated growth here at CDK. As you know, 2 of the top metrics we focus on: our number of sites and revenue per site, with sites indicating the health of our subscription base; and revenue per site, demonstrating our software's increasing value to dealers. This quarter, we had the highest level ever in the history of the company for both of these key metrics.

We've developed a very healthy subscription base now with all the work we've done around being customer-centric. I'm happy to report that we just achieved our highest-ever Net Promoter Score as well. We've also built a great leadership team with a wealth of new talent on top of our strong foundational team that has come together to drive CDK to the next level.

So now I'll hit on some of the key results for the quarter and let Eric dive deeper into all of the details. Then I'd like to spend my time sharing with you the vision for the company and the progress we're making on our strategic initiatives, especially around some of the great technology advances we've recently made.

During the second quarter, we had a revenue of \$406 million, and EBITDA of \$156 million with an EPS of \$0.59 and a strong cash flow generation. When I take a step back and look at the performance drivers of the quarter, the underlying business remains very healthy, but COVID certainly accelerated throughout the quarter and into January. And as you can see from the data in the charts we provided, we're seeing some of the uncertainty reflected in certain areas of our operations. And I'll let Eric provide more details in his remarks.

However, all in all, we continue to feel good about the underlying business with auto site growth up 8 quarters in a row and adjacency sites at their highest level in the company's history. Given the good visibility into our free cash flow and our confidence in the underlying health of the business, we have continued to invest as part of our growth strategy. And you'll see from our guidance, that we expect stronger second half growth.

Our investments over the past 2 years are really showing progress, and we are well positioned to accelerate bringing solutions, insights and value to our dealers, OEM and developers. As a reminder, our strategy is a multipronged approach with initiatives to: one, modernize our current products; two, develop new solutions; three, utilize data, insights and integrations; and finally, fourth, expand and connect the broader ecosystem. I'm going to talk about the progress of each of these and share some thoughts on our vision for the future.

When we think about modernizing our current products, we're looking at: one, having a frictionless user interface that is straightforward, user-friendly and mobile-ready with a simple upgrade path; two, being able to leverage the public cloud with the ability to auto scale and be available anywhere; and three, using flexible architecture to build faster and utilize APIs and plug-in apps. Now plug-in apps are used to quickly add more functionality or new features to existing software. And for example, we just announced the launch of our new rewards plug-in app on Fortellis. And this is the first directly integrated manufacturer loyalty program in any DMS.

On our last call, we mentioned our creation of this program that can be used to instantly access customer rewards points and apply them for payment at a dealership, which flows seamlessly then into the DMS. This new feature has all the modern user interfaces, is easy to use and very simple to install. We are now happy to officially launch the product and have signed with a major OEM to offer this exclusively during their pilot.

This marks the first manufacturer-certified plug-in app available through the Fortellis marketplace. There's going to be more to come later this year.

We're currently working on several modernization efforts, including updating the user experience in our CDK Service application to deliver an easy-to-use interactive interface for our CDK Inspect solution. Additionally, we are adding new AI and machine learning capabilities to drive new database insights, leveraging our new Neuron platform and Fortellis. You'll be hearing more about this as we move into pilot.

Moving on to our new software initiatives. We're focused on addressing several growing needs within the industry, including helping dealers on their journey to provide more omnichannel digital retailing experiences for the consumer. Our strategy is to quickly become the provider of choice for digital retailing solutions through a combination of best-in-class solutions. Given the wide acceptance of our Connected Store product and the investments we've made to compile the most complete set of products needed for true digital retailer, we see a lot of opportunity here and believe we're well positioned to the industry -- to be the industry leader. Our new product development is also focused on meeting the needs of OEMs and consumers with new applications such as our CDK One Pay solution and the new rewards plug-in app.

Our third initiative is around data and insight. And one of the company's greatest asset is data. And I want to share some very important news about our new data platform, Neuron. I'm really excited about the launch of our intelligent big data and analytics platform, which will be a game changer for the industry. By combining Big Data, our deep domain expertise and data science, Neuron will address some of the industry's biggest pain points that will be a huge differentiator for CDK.

So let me explain. There's a massive amount of data, and it's expanding every day from OEMs, dealers and increasingly the cars themselves. Unfortunately, it's not very useful in its current form. In order to really harness all these data, make sense of it and offer actionable insights to OEMs, dealers and software partners, you need a combination of 4 things: a scalable platform, industry domain expertise, AI and machine learning capabilities and an API integration platform all done within a secure and compliant environment. Neuron is the industry's only intelligent data platform capable of doing all these.

And first, Neuron platform is structured to be scalable and capable of handling the volume of structured and unstructured data that's flowing through the automotive ecosystem system. Neuron is built to analyze billions of data transactions that flow through our products annually alongside other industry data, which is a lot of data, but still tiny compared to where the industry is headed. Neuron's architecture is being developed to scale up to many times that amount.

Second, CDK has extensive domain expertise in the automotive and adjacency retailing industries. We know what information is important and what is not, and what dealers and OEMs need. We have 40 years of experience in these industries, and we know how to curate the data, to get them the right data at the right time and in the right form to help them make better decisions.

And third, we've made investments to build out our data science and engineering capabilities in order to curate, manage, analyze and extract knowledge and insights from the data.

Fourth, we have Fortellis, which can securely and seamlessly integrate the insights and data to connect everything together across the automotive ecosystem.

And finally, we're building trust into how we manage data and applying a lot of care to that governance of data to ensure that we are compliant, secure and maintaining data privacy. I'm sure you can see the value this will bring to the industry and our customers.

But what does this mean for CDK? Well, I see this helping us in 3 major ways: first, we're using the insights to enhance our products and solutions to bring even more value to our dealers and OEM customers. This will help with customers' retention, upsell and penetration as well as new customer acquisition.

Second, we'll let others within the ecosystem utilize the platform to build and analyze trends and insights that can then be shared with our customers via Fortellis integrations. This will further increase the value customers get from our DMS and integration as well as generate revenue for CDK via Fortellis.

And third, we can expand outside our vertical to broaden the connections with nonautomotive partners, which will increase revenue potential outside our current TAM. All of these lead to revenue opportunities for CDK and puts us at the forefront of innovation in the data intelligence space.

Last week, we announced the acquisition of Square Root, a top developer of technology for data insights and curation for auto OEMs. While this is a smaller acquisition, it's a good example of the type of M&A that fits with our strategy. The acquisition brings with it technology and data analytic capabilities that will complement and accelerate our Neuron platform initiatives. Their customer base and deep analytics talent will be additive and easy to integrate within our current business. We're really excited about the opportunities that Neuron will bring to CDK and we'll be sharing more about this and some of our other technology innovations at an event you'll be hearing about this spring, so more to come.

And then finally, our fourth initiative is about connecting the ecosystem, and I'd like to share some really great updates on Fortellis. And as I mentioned on our last call, we track the growth of Fortellis by looking at the number of data transactions with an annual goal to reach 100 million by the end of this year.

During Q2, we generated over 18 million transactions, which was a 33% increase over last quarter, and we're well on our way towards making our 100 million goal for fiscal '21. We added several new APIs and ISV partners. Our repair order API is really starting to take off. On our year-end call last August, we said repair order had over 30 installed dealers generating over 100,000 transactions. We now have over 350 dealers installed, generating over 3.5 million transactions. This is really exciting to watch.

Let me wrap up by providing an update on our International sales and also talk to you about our capital allocation strategy. We're making good progress on finalizing the International sale and are on schedule to close the transaction during our fiscal third quarter. We decided to sell the International business for several reasons. I'm a strong believer that companies can't be great at everything, and you really have to pick and choose where you're going to focus on. We've been doing that with products, and so we did the same thing with our portfolio of businesses. We looked at the fact that the International OEM and dealership business models and workflows are very different than in North America.

Also, the architecture and language of the CDK International technology is unique and proprietary, such that all the work we're doing in North America to reimagine our products and technology wasn't going to apply to that business. When comparing the attractiveness of both businesses, we determined there's just too much opportunity in North America. We ran a process that had many interested parties at attractive valuations. We were very pleased to be able to announce the sale in November, and are now focused on the closing and our capital allocation strategy for the proceeds. And one of the things we're going to do is to pay off some of our debt in order to reduce our leverage and strengthen our balance sheet. And this will allow for flexibility as we look at opportunities to further grow our business.

We're constantly looking at acquisitions and have a strategy to focus on great technology that can quickly integrate and be positive to the top and bottom line. We think there are several good opportunities out there that could enhance our product core or expand our tech capabilities in order to grow faster. At this time, we're confident in our ability to deploy significant capital to grow the business and create value for our shareholders. We'll run a disciplined process as we evaluate investments and continue to monitor our balance sheets over time, returning any excess capital that we can't deploy efficiently to shareholders.

I'll now turn it over to Joe for the business operations highlights of the quarter.

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

Thanks, Brian.

First, let me take a moment to welcome Eric, our new CFO, to the team. I'm thrilled to have him here. It's been great to bring somebody in who has hit the ground running, and I'm really looking forward to working with you. I also couldn't be more excited about moving full time into the COO

role. With our strategy and investments we've made over the last couple of years that Brian highlighted, I think I'm uniquely positioned to work with our CDK teams to deliver for our customers and accelerate our growth, and I'm excited to jump right in.

Today, I'll be sharing some insights about our performance in the quarter. In particular, details around our core software business, how we are thinking about our approach to data and our progress with Fortellis. I'll then talk about how we work more efficiently as a company to continue to increase profitability and create capacity for investment.

One of the first steps we took towards improving the revenue growth of our business actually started a couple of years ago when we put so much emphasis on being customer-centric. As Brian mentioned, we achieved the highest level ever for the company in our Net Promoter Score, which measures how our customers view CDK. This is a huge proof point that the changes we've made are meeting the evolving needs of our customers with our improved installation quality, improved tech support experience, as well as improvements in our billing and ease of contracting. As a result of these efforts, we obtained large increases in the percentage of customers who indicated they are likely to renew. And in customers who said that CDK is making it easier for them to do business with us. This is really great news, and I'm very proud of the entire CDK team for their continued efforts to put our customers first. A big congratulations to all, and we will continue to raise the bar from here.

As a reminder, the way we think about revenue opportunities is: one, growth within our DMS and strategic applications business; two, from our data strategy and Neuron platform; and three, from Fortellis.

So now let's double-click into this, starting with some overall sales highlights. Looking at our sales performance during the quarter. We delivered a solid sales quarter across the board. We sold more DMS sites than we did a year ago and continued to see strong sales in our applications.

We continue to see good demand in products that support digital retailing, such as Connected Store and our digital contracting solutions like eSign and Sign Anywhere, which are all helping dealers provide a seamless omnichannel buying experience to their customers. For example, in each month during the quarter, more than 1.4 million documents were signed electronically using our eSign solution. Our recreation sector had the highest sales quarter in company history with December producing a historic number of new deals in any 1 month. Sales were also strong in heavy equipment, including a new networking contract for a 70-site dealership.

Our install team had a great quarter and continues to deliver new installs while managing the challenges of COVID. This quarter, we did more installs of our DMS, CRM and service applications than during the same period last year. Our DMS install rate for the quarter was the highest since 2015, and our service application installation volume grew over 100% from the prior year. All this work sets us up well as we look forward to fiscal 2022.

Now moving to performance on site and our DMS business. Looking at our entire portfolio of sites, which includes auto sites from both franchised and independent dealers and adjacency sites from dealers in areas like recreation and heavy equipment, we currently have the highest site count in company history at 14,851 sites.

Breaking it down by businesses. Auto sites ended at 8,997 and grew sequentially by 31 and year-over-year by 23, with continued growth in the 3-plus site dealer group, offsetting declines in the 1- to 2-site dealer group. Adjacency sites came in at 5,854 and were up sequentially by 50 and year-over-year by 52 to the highest site level in company history.

We continue to focus on enhancements to our Drive Flex product and have delivered new OEM capabilities for Ferrari, Honda and Acura for franchise dealers. That brings our total OEM certifications to 11. At this point, we have over 60 customers on Drive Flex and our technology teams continue to make progress in advancing its capabilities.

When we look at the independent market, we're winning several new dealers here and see a clear opportunity by the end of our fiscal year for our DMS to be one of the leading solutions in this space. We continue to build out the robustness of Drive Flex for more complex dealers and will continue to report our progress each quarter.

Moving on to our applications. One of the biggest growth opportunities for us is in the application space, both those that we integrate into our DMS and those that we sell stand-alone and integrate into other DMSs. Our top growing applications are in digital retailing with Connected Store, Doc Cloud with our digitization of document storage, our ELEAD CRM suite as well as our CDK Service application to name a few.

Our underlying growth is certainly being fueled by our dealers adopting these applications, and there is plenty of opportunity for us as we bring our next-generation versions like Service to market.

Let me share a few more details about these opportunities. Looking at ELEAD, the popularity of the application with dealers has consistently been strong. Since the acquisition, we've grown ELEAD sites by more than 50%. Our penetration in our DMS base is about 1/3, while our penetration with dealers who don't have our DMS has grown to over 20%. This is real proof point of the power of our subscription base, sales team and ability to successfully integrate such a great acquisition into the portfolio.

Looking at our Service products. We have nearly 3,500 sites on our Service software with penetration within our DMS base being roughly 1/3, penetration outside of our DMS installed base is less than 10% and represents a strong opportunity for us as we head into fiscal 2022 and bring our enhanced Service software to market. The Service business has largely been built by our organic efforts over the last few years and reinforces the benefit of investing to continually improve our software.

Lastly is digital retailing, providing a seamless end-to-end shopping experience, as Brian discussed, is a top priority for us by offering digital retailing solutions that are connected to our Connected Store product. We are focused on providing a consistent branded experience for the consumer when buying a vehicle. From capturing the lead that often starts at the OEM's website to the sales lead in CRM through the finance and insurance process and all the way through to closing the deal with an e-signature.

The penetration of our Connected Store application is around 10% and growing as more dealers adopt our solution. We view the non-DMS market as full greenfield as our development teams work hard to bring an agnostic version of the product to market.

Overall, we feel good about our underlying growth and our opportunity to accelerate revenue as we head into fiscal 2022. As I look at 2021 and in particular, Q2, COVID continues to have a significant impact on our business. The impacts we continue to see on our revenue are as follows: the ongoing accounting impact from the discounts and free products we gave our dealers to support them during the height of the COVID shutdown last year as well as the implementation delays we experienced during this time. The slowdown in on-premise consulting work due to safety and social distancing efforts and the decrease in discretionary spending on call center business. And the fact that our customers continue to face uncertainties about how COVID will impact their operations and the general economy.

Moving on to Neuron data strategy and revenue growth opportunities. As you heard from Brian, we'll be utilizing insights from Neuron to enhance our products, which will support improved revenue growth within both our DMS and applications. We will also be growing revenue through our connections with OEMs and other third-party partners within the ecosystem. We believe the value we bring to market through Neuron will drive revenues that help provide some offsets to headwinds we may experience from our Partner Program transition.

As you know, we are transforming our approach to the Partner Program by better allocating value across our solutions, while working hard to absorb any additional headwinds due to timing mismatches.

During Q2, we saw headwinds to our subscription revenue due to these efforts, but are seeing overall progress in transforming this program. While we know the progress will not always be linear, we are on the right track.

The last growth opportunity I want to focus on is our Fortellis platform. As you know, this platform is growing, and we are currently seeing good results from our Hailer app with Lyft and our new Repair Order API.

I'd like to talk about another exciting offering that we are well into the successful pilot phase of, which is our new CDK One Pay solution, which is seeing strong interest from dealers. As we mentioned on our last call, this product, in partnership with Global Payments, will modernize the entire

payment experience at a dealership and integrate seamlessly into our DMS via Fortellis. We expect this to be a growth driver in fiscal '22 for CDK as we move into general release shortly, and I look forward to sharing more metrics in this area in future quarters.

Moving over to the operations side of things, I'd like to provide an update on our Business Process Modernization program. While we've seen benefits in our NPS from the program, as customers see the results of our improvements in billings. The program goes well beyond just solving that issue. It was a large effort that will drive efficiency and scalability as we lower unit costs by providing standardization for things like our software offerings, quoting, and installations, which will yield better satisfaction for our customers and more productivity from our employees.

To put things in perspective, we're going from over 10,000 SKUs that our sales team could sell to a goal of reducing it to under 1,000. The efficiencies that we can gain through standardization will result in an improved customer experience as well as higher gross margins and will provide additional capacity for investments.

In closing, I've spent time in this last week reflecting now in my 3-plus years as the CDK CFO, and I'm quite proud of all that we've accomplished as a company and as a finance team. We've significantly improved our metrics in how we run the company, have made changes to our portfolio that positions us well for the future and strengthens our balance sheet. And have planted at the right seeds over the last 2 years to accelerate revenue growth and position the company for the long term.

I look forward to working with the team, and I'm committed to executing our growth strategy and continued transformation.

Now I will turn the call over to Eric.

Eric Guerin - CDK Global, Inc. - Executive VP & CFO

Hello, everyone, and thank you to both Brian and Joe for their nice comments. It's been very exciting getting to know CDK over the past few weeks and the great team here.

I've already jumped into the mix on several key projects like the International sale, the Square Root acquisition and the Business Process Modernization which I've lived through something similar before and look forward to sharing my experience.

My overall priorities as CFO of accelerating profitable growth and driving operational excellence will focus on supporting the great momentum we've got here and providing key financial insights to make the best possible decisions. I'm looking forward to working closely with our employees and the entire executive team as well as getting to know our shareholders, research analysts and customers in the coming months.

So now on to the results. I'd like to remind everyone the results are for continuing operations only, and do not include the International business, which is now presented as discontinued operations and prior periods have been reclassified to reflect this. We are also now reporting on a consolidated basis with no segment reporting.

For the second quarter, we delivered revenue of \$406 million, approximately 3% behind the same quarter in the prior year. Subscription revenue was \$328 million, which was up sequentially from our first quarter, but down 3% over the strong performance we had in Q2 of last year. Underlying subscription revenue growth was driven by auto site increases of 23 year-over-year, with revenue per site up 2%.

We saw continued strength in total recurring revenue from our 3-plus site auto dealer group, offset by a slight decline from the 1- to 2-site group. Adjacency sites were up 52 with robust site growth in heavy equipment sector, adjacency revenue per site was up 3%.

The solid underlying growth within our core subscription business was more than offset by the ongoing transformation of our Partner Program and amortization of past COVID-related discounts and free products, as Joe mentioned in his comments.

Transaction revenue for the quarter was \$39 million versus \$40 million last year. Other revenue was \$37 million versus \$39 million last year, due to gains in Cloud Connect networking hardware, offset by COVID-related decreases in consulting and call center businesses.

Now turning to earnings. Second quarter EBITDA was \$156 million versus \$175 million last year with a margin of 38.3%. In addition to the impact of lower revenue, earnings were pressured by our incremental spending on strategic investments and a change in our employee vacation policy, partially offset by tight management of operating and travel expenses. To provide further clarity around the vacation policy impact, we've historically experienced a seasonal increase in earnings in our fiscal second quarter due to when we trued up our accrual for unused vacation days. In calendar year 2020, we changed our vacation policy such that this seasonality no longer benefits us in Q2.

Our effective tax rate was 26.2% for the quarter, up from 25.5% in the same period last year, primarily due to an increase in state income tax and less benefit from foreign tax credits. Quarterly diluted earnings per share were \$0.59 versus \$0.71 last year.

With respect to our balance sheet and liquidity position, cash as reported on our balance sheet was \$63 million, with \$238 million of cash within our International business being reported as assets held for sale. We plan to repatriate the excess cash to the U.S. before the sale of the International business closes in the third quarter. Access to liquidity remains strong with \$750 million available on our revolving credit facility.

Year-to-date, we delivered free cash flow of \$112 million, including the expected settlement payment of a lawsuit we discussed on our last call and the payment of \$37 million in cash dividends to shareholders.

Before I provide guidance, let me share some context around our expectations. Our guidance includes our latest view on managing the impact of COVID on our business. Our effort to minimize the financial burden of dis-synergies and stranded costs related to the International sale and our continued focus on prudent management of strategic incremental investments, which are now closer to approximately \$20 million for the full fiscal year.

We expect the International sale to be finalized during Q3, with net proceeds estimated at approximately \$1.25 billion after taxes and expenses. We expect a strong balance sheet as we de-lever through the paydown of some of our debt with lower interest expense anticipated going forward. We're providing fiscal year '21 annual guidance on a continued operation basis only to reflect the sale of the International business.

With all of these factors in mind, we expect total revenue for the fiscal year '21 to be \$1.66 billion to \$1.71 billion, EBITDA to be \$640 million to \$680 million and EPS to be \$2.45 to \$2.75, with a tax rate within the range of 26% to 27%.

In summary, I'm quite happy with the progress we've made on our customer and technology strategy, our focus on our North America business and our strong financial profile. I believe there are enormous opportunities ahead for CDK and I look forward to working with the team to deliver on our commitments.

Thank you. And now, we will open it up for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from Charles Nabhan from Wells Fargo.

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

I wanted to get a little more color around the site count. You specifically mentioned that increases in the large dealer count offset some declines in the small dealer count. And I wanted to get a sense for, given the progress in Drive Flex, when you expect that small dealer site count to stabilize?

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

So I can start and then -- this is Brian, and then Joe can add in. I'd tell you that we're already seeing improvement in the small site count, and we've cut the loss rate in the small dealers, less than 3, by almost half. So there's quite a bit of improvement already.

And as we continue to put both improvements into Drive because many of those small dealers still want to use the capabilities that come with Drive and Drive Flex, we think we can continue to turn that into eventually growth. Now that probably is going to take another year-or-so before we can actually see growth in that space, but that is our target.

But in the short term, we are seeing pretty dramatic improvement in that space. And a lot of that's been really not only making improvements in our products, but making our improvements in customer support. Those are the guys who, typically, you look at things like customer success, having people get out there and talk to them about their business and they look for that kind of work, consulting, time that it takes to answer calls into the help line, all of those improvements have really helped especially that smaller dealer network. But let me add to this Joe and see if he has adds to that.

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

Yes. No, I think it's well said, Brian. We're really proud of the team. The record NPS score that we've seen this quarter really sets us up well. As Brian said, the year-over-year comparisons still show a decline. But when you look at the last couple of quarters, you see more stabilization in that lower end of the business. And we're really pleased with the sequential site growth improvement. Our installation teams continue to work with dealers to safely implement our solutions. And as you can see, the underlying business continues to really churn out both billing and revenue per site growth as well as seq growth.

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

Got it. Appreciate the color. As a follow-up, I wanted to ask about Fortellis. I appreciate the color around transactions, but one of the questions we seem to get quite often is how that translates to revenue. So any color around that would be helpful.

And secondly, you talked a little about next-gen apps including the payment app. And I wanted to get a sense for as you move forward in the development of your apps, could we expect them to be delivered through Fortellis as opposed to the traditional method of integration through the DMS.

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

So this -- let's start with -- it's Brian again, let's start with the second one because that's a very simple answer and the answer yes. Fortellis will be the way most things will get delivered now and into the future. And the reason is it's all API-based. It's oftentimes, depending on what the application is, it could be a simple click of a button within the DMS but would download that app. Let's say, you want to download Zoom because you want to do a Zoom call, we'll make an API that links to Zoom and you'll be able to click in. If you want to do Hailer and do Lyft calls, we'll make a simple button and it will download that application into the DMS and off it will go. So this is a modern and very efficient way and very simple way to deliver those things.

The first part of your question was more about, okay, transactions versus revenue? And how do you think about that? And here's the way we think about Fortellis is that first off, we're building an ecosystem. And the key here is to really entice and excite developers, third-party developers who build products on Fortellis that integrate both with our software, but without third-party software as well. There'll be some that never actually uses our DMS. Maybe it goes -- it sits on Fortellis and texts to some other third-parties service application or whatever.

The way we'll charge for Fortellis will depend on the amount of engineering and, basically, efforts that goes into whatever the application is that people are doing. So for example, if somebody is just doing a data download to pull into their Excel spreadsheet, we may charge very little to

nothing because that doesn't really require a lot of engineering on our part. And we're just storing their data at a fairly efficient and low cost. But whoever's data that is, we may charge for a small fee there, but it's not much.

There's other applications like the Service RO application, or Repair order application, which has a lot of calculation that goes into it. There's a lot of embedded engineering that goes into that application that looks at things like is it a warranty part? How do we go back into the DMS and calculate the books? And all of that, and it's managing all of that data just that somebody can just simply enter in the Repair Order and it takes care of it through the DMS through connection to the CRM or whatever. And that were adding a lot of value, and we charge for that then. And we charge a fair price like anybody else would on an engineering application. So you're going to see, as Fortellis grows, kind of both of those extremes and things in between as well, that really drive the revenue of this.

But right now, the reason we are trying to show you the transactions is that, that's the key here is that as that grows, we'll entice more developers and some of those applications will have that engineering into them and we will charge to it. But our target here is to grow 8 to 10x every year on Fortellis and that will deliver that revenue growth over time.

And Joe, if you have other inputs?

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

No. The only thing I would say, BK, is that the big distinction, Chuck, that we're seeing is, think about what Brian just said, which is we're starting with how do we create value for the dealers to sell more vehicles, to service more vehicles. How do we start with the end customer to drive a better end customer experience? How do we help engage and integrate OEMs to be able to create more value-added connectivity there? As long as we start with that value as the first leading case, then the monetization and the value that's created all comes as a result of that, and I thought Brian laid out the structure right. But it's pretty exciting when you look at the use cases, every one of them that we talked about in the script today really pivots the company in a very different way than we have historically.

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

The only thing I would add to what Joe just said is the other thing that is really neat about Fortellis is that because it's all API-driven, and it is modern, it allows us to integrate opportunities very quickly. So you heard about our Square Root application -- or acquisition, excuse me, that will help -- Fortellis will help us integrate a lot of their applications and their technology much quicker. You saw our payment partnership that we've just put out there. That is going to be integrated through Fortellis, and it allows us to do that integration with third parties that we will get paid quite nicely for on a per transaction basis.

So it's really going to be the engine that helps us grow our business even if it's "not Fortellis" that's getting paid for that transaction, but it's allowing us to integrate with applications that we are getting paid for. And so it's going to be convoluted how it does, but it's going to transform the rate at which we're able to make change and improvement.

Operator

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

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

Brian, you mentioned that this Neuron product is a game changer. So a couple of things here. Number one is will this be sold on a subscription basis or a transaction basis? You did mention you will get paid for it, so we'd like to delve into that a little bit.

And then could you also give us an idea of some of the key data insights that this can develop that dealers really want and need in the market right now?

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

Sure, Gary. I was a little concerned about that big sigh at the start of your question, just...

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

No. I had to think a lot to get that out.

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

So think of Neuron as you're really re-architecting our internal database and restructuring it, getting everything labeled to getting everything tagged, building how the data will flow in and out of the architecture. And that's been a huge task. What you get at the end of that is now a database that's scalable. The way it was architected within CDK prior that, it was broken up in many little data ponds. It wasn't scalable. There was often duplicated data things like that. So we've really been going through this cleanup process in this process of turning it into a manageable, scalable architecture that can now have applications applied to it.

And the second part of your question is will we charge for that? Again, it's going to depend on the application. So we won't necessarily just charge people to put their data into Neuron. If you're a dealer and you're using our DMS and you're using our layered applications, whatever, Neuron comes with it. What it allows us to do, though, is aggregate all the data from our applications, from third-party applications, all of this and provides us info.

Our game plan here is that you'll have kind of a good, better, best. Some of those insights will just get built into our products. It will go to our DMS, it will go to our CRM, will go in to our Service tools. And then some of those applications or insights will have very high levels of engineering applied to them, and those will get paid for.

So let's give an example of something like inventory, having the ability to look at all of your used car inventory on your lot. And on it literally a real-time basis, scanning that inventory, looking at the price that you've got it listed at, looking at all the other colors that are selling out there, at various other locations. And looking at the days on lot, having that insight into what would be your best strategy around that is an insight that we provide.

Another thing is Service. You're looking at all the Service reservations you have, who's coming in, what kind of cars those are, all of that. You can look at all the other cars that are being driven that have similar mileage and similar features that are in a certain radius. And we can start helping them look at their parts inventory and saying, "Hey, by the way, these parts coming in for squeaky breaks. But by the way, if you look at all the other cars in the 100-mile radius that are that age and that model number, and we're looking at cars that have that kind of issue over the last 6 months. We typically require these parts. We suggest you stock those parts. You're actually short on them and you have these many coming in next week." That's really helpful because that makes the dealer much more efficient and to then be able to service their customers better.

Those are just 2 examples. We have hundreds literally that we've been thinking about that we can apply, whether it's the inventory, whether it's predictability about as you look at your CRM data and you can predict who's a better customer and who's more likely to buy a car. And those can be prioritized against your CRM data.

You can look at what's the highest probability of upsells within cars when you're selling the car. What kind of service you can likely upsell when certain cars and new customers come in. All of that prediction is things that we're used to on our phones today, but they aren't happening in the dealer world. And by aggregating the data in Neuron database and then deals like we're doing with Square Root, we're going to be able to provide that into the DMS, into the CRM, into the industry.

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

Great. That's a great answer. And then just real quickly, a quick one. Rank order your preferences for the proceeds from the sale of the CDK International business, debt reduction, stock repurchases, acquisitions?

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

I'll tell you what, I'll start, and then I'm going to let Joe and Eric both give their opinion. Mine's pretty simple. And what my priority might be versus what will actually happen is not necessarily going to be perfectly aligned. So I always believe you invest in the business first. If I know of a way to take the cash, whatever it is, the sale or just our normal free cash flow, and apply it and invest into the business. And I see a return because we do everything around an NPV and a return on investment basis. Then I think that's always the number one thing. And the management team and I are here to grow this business.

But after that, if there's not -- and there's organic and there's inorganic in that growth, right? So it could be -- we're investing in our engineering teams or we're investing through an acquisition mode. After that, it would be dividends. And then lastly, buybacks kind of something like that. And I'd put debt repayment in there based on opportunity, right? What's the terms on repayment or are we allowed to do repayments? So I would put repayment above dividend or buybacks as well. But that has to be timed and opportunistic.

I think when you look at the proceeds that we're getting from International, you're definitely going to see some debt reduction. I mean we said that in our statement we'll do some with that. We're having some discussion about how much and what timing and things like that internally. I think we're actually becoming pretty well aligned, but you'll see some pretty big piece of it going towards debt reduction. I don't think we'll have to do any other investments organically that we haven't already forecasted. So I don't see a lot of additions there. And the rest will look for other opportunities, whether it or inorganic or whether it be buybacks or whatever.

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

Gary, I wouldn't add a lot to what Brian said, the only part I would add is just to take a moment to say, it's been a heck of a quarter, right? When you look at the international sale and the net proceeds of \$1.25 billion, and it just gives an indication to the value opportunities as we look at even accelerating to the North America business further. And so we're quite excited about that, and we'll be very thoughtful between Eric and myself and Brian on a returns-based framework as we evaluate the decision points Brian laid out.

Operator

And our next question comes from Ian Zaffino from Oppenheimer.

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

I just wanted to just touch on the cadence of the quarters. I guess you're expecting a pretty strong second half. What is effectively driving that versus maybe the first half of the year? And sort of how we think about that ramping? And again, maybe the drivers of the strength and maybe the drivers of your optimism?

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

Yes. So maybe I'll start out, Ian, and good to hear from you, and I'll let Eric take it from there. So from our perspective, COVID had a pretty meaningful impact in this quarter, particularly in the areas that are more discretionary. And you can really see that when you look at the site growth and the revenue of billing per site growth, some of the discretionary areas of the business were quite impacted.

As we go into the second half of the year, we have good visibility with our backlog and everything else going on. The way I would think about the second half would be revenue and EBITDA surely evenly split between Q3, Q4. And what I think underneath that is sequentially walking Q2 to Q3, you're right to point out the seasonality of the North America business as it's going forward, is different than what CDK Global was before. And so normal, in our fiscal Q3, which you'll experience upcoming, is our revenue stream uptick from our tax filing business.

And then you've really seen subscription revenue with the installs that we're doing, build momentum. I talked about in my section, it being a record quarter for DMS installs this quarter back to 2015. And I think you could start to see sequentially that come in to help Q3 out, the tax filing business come into Q3. And then really Q4 start to build momentum as we exit the year and set us up well for 2022. That's how you should think about the cadence from our perspective.

Eric, anything you would add to that?

Eric Guerin - *CDK Global, Inc. - Executive VP & CFO*

No. Joe, I think you covered it nicely. The only thing I would add is if you look at our annual guidance, it does represent that. We feel pretty good about Q3 and Q4, as Joe indicated, them looking pretty much like Q3 and Q4 as we move forward to the back half of the year.

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

Okay. So let me ask you another deeper question on that is the guidance seems to be unchanged if you back-out discontinued ops. So were there things that you maybe thought would have been booked in the second quarter that will now be booked in the third quarter? Were there pushouts? Is there demand that you'll be able to recoup and mean demand wasn't lost? I'm just trying to get a better handle on kind of what you're seeing in the second half versus what we saw in the first half.

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

I'm trying to absorb your question. I don't -- if you make the comment when you compare it to our numbers, it's coming in not far from where we thought it would. So I don't -- from our perspective, we see momentum continuing to carry forward into Q3, Q4, the way I described. So when you look at it year-over-year, if you recall last year, COVID started to hit around mid-March is really where we saw it in the North America business. And so the comparisons get a bit easier in Q3 and then more so in Q4. And so I don't think there's anything unusual I would point to, Ian, other than the items I described earlier.

Eric, anything else you would add?

Eric Guerin - *CDK Global, Inc. - Executive VP & CFO*

No, I agree with you, Joe.

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

Hey, Joe, I think the question was asking a little bit separate. There are things like our consulting business that was impacted in the second quarter that we believe picks back up as dealers. There were certain activities, there were installs, there were consulting some of those businesses plus some of the transactional businesses that were down in the second quarter that we think as COVID restrictions and kind of behaviors relaxed a little bit, those come back in the third and fourth quarter. And those are missed or opportunities that got pushed.

So we've sold and signed a contract on. Our backlog for installs is quite high on many of our products right now because the dealers have asked us not to come on site and do some of these installs. And so those get pushed into the third and fourth quarter. And we're already seeing the relaxation in many cases. I think that's part of the answer that Ian was looking for as well.

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

Yes, I think that's fair context. So when you look at the consulting business is a good one, we've booked a fair amount of business. It's ready to be installed. Again, we haven't put all of that in. But certainly, we think some of that sense would have come back a bit.

Operator

And our next question comes from Josh Baer from Morgan Stanley.

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

I was hoping you could give an example of what happens when a customer adopts additional applications. So maybe focusing on auto, 9,000 per site, per month. If you assume DMS is 4,000 or 5,000 and the rest are apps. How many apps does that represent? I mean, are those numbers right? And what happens if you attach an additional 1 or 2 applications.

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

Yes, sure. So I'll start out and then Brian can add in. So I think your numbers are directionally correct. And listen, I think our sales team does a great job working with the dealer to bring the dealer solutions.

And from our perspective, today, we're about -- as you heard in my remarks, into our DMS penetrated base, we're about 1/3, 30% - 35% depending on the application penetrated into the basin. The way you should think about it as we add in that new capability and bundle in more applications, you see that revenue per site increase as it has been.

And particularly, when we get down to the other side of some of the COVID discounts, you'll see that continue to accelerate further. The new opportunity we have, and then as Eric and I talked about as he gets on board, sharing more transparency, the metrics, we have a new opportunity that's starting to really accelerate, which is non DMS opportunities to sell applications.

As we look at -- Brian talked about in his remarks, bringing on Service Flex to the market. We already have the ELead stand-alone solution. And again, it's an average revenue per site for the applications that we sell stand-alone. And that's really a quite significant new TAM expansion opportunity for us that we're bringing to market.

Brian, anything else you would add on?

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

The only thing I'd tell you is that -- so I think the root of the question is how much does it go up? If they add some application or whatever that is. And the problem is it varies quite a bit. Some of our applications that are added onto the DMS are a couple of hundred dollars a month. Some of them are over \$1,000, the more complex and advanced ones like CRM and all. So it can vary quite a bit. But they're all in that range, kind of.

Operator, this would be the last question.

Operator

And your last question comes from the line of Rayna Kumar from Evercore ISI.

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

Could you first discuss your thoughts on how dealer sites could look for the back half of FY '21? And then second, you spoke a little bit about some implementation delays that are being pushed from 2Q into 3Q. Could you quantify the revenue from those delays for us?

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

I can start. So right now, we continue to model that we'll continue to grow sites somewhere in that 1% to 2%, if you look at the DMS growth rate, right? So my goal is to cross over well into the low 9,000s from the -- what is it, 8,997, Joe, that we're at today?

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

Yes.

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

So I expect us to be well above 9,000 as we exit this year. Just so you know, we already have our sights set on how do we cross 10,000? And what does it take? And how do we have to improve and what -- how do we deliver a better service to our customers to continue to grow into that range. I don't think we actually ever break out the dollars on these things from that standpoint. But I'm not sure, Joe, if we have in the past, right? I don't think we have.

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

Yes. No. We won't get into that little of detail, but for sure, most of the installation team has been pushing hard. Nonetheless, you want to make sure it's done appropriately and comfort with the dealer with our teams. And we have a very strong backlog, and we continue to expect and see positive momentum and sequential site growth as we go into the second half of the year.

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

Got it. It's very helpful. And then one follow-up. Could you talk a little bit about the competitive environment you're seeing for 3-plus site dealers group? And then also for some of the smaller dealers? Any change in dynamics there?

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

I would tell you that the dynamics haven't dramatically changed. We've probably seen a bit of a pickup in acquisitions and consolidation, say, in the last 4 or 5 months. So the big guys are tending to go out and do some purchases now. So that the guys are getting a little bigger. Some of the smaller guys are growing a bit too. The competitive dynamics have stayed the same, right?

There's the other big guys in the DMS space, there's quite a few in the layered application space that are quite competitive. I don't think, Rayna, the competitive dynamics, if I looked a year ago, to today. I wouldn't say there's much of a difference in the environment right now. It's always been competitive. And I think part of what we're doing, and you saw our actions in this quarter, is to really figure out where we want to be great, focusing on those, do the right thing for the business in those areas where we're not, where we don't want to, and make those investments and then to

hold ourselves accountable. And so you've seen the work we've done on the DMS, the layered applications around CRM and Service. Joe talked to you about the great growth we've had in CRM.

But you saw us also make the decision to sell the International business because that was one that we weren't going to make those investments in and it was the right thing to go and do for the business. But competitively, it's not the same.

I'd just like to bring it to a close for today. I really want to thank everybody for taking the time attending our call. I really hope you see the really the good work the team has done over this year.

I think we've navigated the COVID environment and the other changing environments out there quite well. We've laid out our strategy over the last 2-plus years now. And I think you're really starting to see the results pay out and really see the changes occur. And you see that in things like NPS, you see it in site growth, and you see it in our overall performance. And so thank you very much, and I'd really like to thank the CDK team for a great quarter and really continuing to contribute at an extremely high level. And so until next quarter, thank you, everyone.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect.

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