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EDITED TRANSCRIPT

CCSI.OQ - Q2 2023 Consensus Cloud Solutions Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to Consensus Q2 2023 Earnings Call. My name is Paul, and I will be the operator assisting you today. (Operator Instructions)

On this call from Consensus will be Scott Turicchi, CEO; John Nebergall, COO; Jim Malone, CFO; Johnny Hecker, Executive Vice President of Operations; and Adam Varon, Senior Vice President of Finance.

I will now turn the call over to Adam Varon, Senior Vice President of Finance at Consensus. Thank you. You may begin.

Adam Varon - *Consensus Cloud Solutions, Inc. - SVP of Finance*

Good afternoon, and welcome to the Consensus investor call to discuss our Q2 2023 financial results, other key information, and 2023 guidance. Joining me today are Scott Turicchi, CEO; John Nebergall, COO; Johnny Hecker, EVP of Operations; and Jim Malone, CFO.

The earnings call will begin with Scott providing opening remarks. John will give an update on our operational progress since our Q1 investor call; Johnny will discuss progress on our go-to-market realignment; and then, Jim will wrap it up to discuss our Q2 2023 financial results and '23 guidance. After we finish our prepared remarks, we will conduct a Q&A session. At that time, the operator will instruct you on procedures for asking a question.

Before we begin our prepared remarks, allow me to direct you to the safe harbor language on Slide 2. As you know, this call and webcast will include forward-looking statements. Such statements may involve risks and uncertainties that would cause actual results to differ materially from the anticipated results.

Some of those risks and uncertainties include, but are not limited to, the risk factors outlined on Slide 3 that we have disclosed in our 10-K SEC filings, as well as a summary of those risk factors that we have included as part of the slide show for the webcast. We refer you to discussions in those documents regarding safe harbor language as well as forward-looking statements.

Now let me turn this call over to Scott.

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R. Scott Turicchi - *Consensus Cloud Solutions, Inc. - CEO & Director*

Thank you, Adam. While there are many important accomplishments in the quarter, most of them are not yet producing meaningful revenue. As a result, and coupled with continuing slow decision-making from our prospective corporate customers, weak results from Summit and some near-term loss of efficiency due to our internal sales force realignment, our top-line revenue was weaker than anticipated and has influenced us to focus on the lower end of our revenue guidance for the year.

Our focus on cost have allowed us to maintain an EBITDA margin, consistent with our guidance range of between 50% and 55%. By investing our excess cash, improving our tax position, and reducing our share count, our bottom line non-GAAP EPS is ahead of our expectations and should be above the midpoint of our guidance for the year. I will now provide some additional commentary regarding various aspects of our business before handing the call over to John.

As noted in our press release, we have made significant progress in our go-to-market realignment. Based on the customer buying motions that we will outline in a later slide, the realignment is showing early success with the pipeline growing significantly from Q1 2023. In addition, we continue to see strong fax volumes in the quarter, slightly ahead of our Q1 record results. However, this process of realignment and the continuation of slow decision-making in the healthcare sector for new business, which we have addressed for several quarters, did impact our revenue for the quarter in our corporate channel, which grew 6%, exclusive of Summit, and 3.1% in the aggregate.

Turning to our Clarity product. We have signed our first customer on Clarity and also decided to produce additional variations of Clarity to address specific needs in healthcare. Our first customer is using the service for prior authorizations, which is a $1.9 billion a year business and expected to grow to $4.1 billion by 2028, according to Global Market Estimates research. As a result, the service to address prior auths will be known as Clarity PA. Additionally, we will be announcing the release of Clarity CD. This service will allow unstructured clinical data from faxes and scanned documents to be routed into the correct patient record. Look for our press release in the coming days to learn more about this service.

As we discussed last quarter, the VA began the rollout of the ECFax service. As of the end of July, the initial group of 10 sites encompassing 40 facilities has been successfully rolled out. A plan is now being developed for the implementation of more facilities this year. In addition, there are approximately 30 additional agencies interested in ECFax solution. Cognosante has begun more detailed conversations with several of these agencies. Our SOHO customer base has now completed the price increase that began last year. We are pleased that the cancel rate for the SOHO customers returned to the near-historic monthly average of 3.5% per month during the quarter.

Before handing the call over to John, I'd like to discuss our liquidity and capital allocation opportunities. In the quarter, we generated positive free cash flow with an approximately $8 million improvement from Q2 2022. I remind everyone that we generate most of our free cash flow in quarters 1 and 3 due to the interest payments that we make in quarters 2 and 4. We ended the quarter with $112 million of cash and investments, a record for us, after spending $10.1 million in capitalized expenses and $2 million in the repurchase of 67,000 shares of our stock during the quarter.

In terms of our capital allocation strategy, we focus in the near term on investments in the business, both capitalized and expense, followed by opportunistic share repurchases. We have built cash balances because it is our goal to retire some of our debt prior to maturity. It is our belief that the credit markets will not return in the near to intermediate term to the favorable rate environment that existed in the summer of 2021 when the bonds were issued. Due to limitations imposed by the spin, we've not been able to repurchase debt until the second anniversary of the spin, which is this October. We are now studying the options available for us to effectuate repurchases of our debt.

I'll now turn the call over to John.

John Nebergall - *Consensus Cloud Solutions, Inc. - COO*

Thank you, Scott. Today, in the operations update, we will look at our sales results for the quarter, give a high-level update on the SOHO revenue stream, comment on our overall pipeline and bring you up to speed with key product and engineering progress. Following that, I'll turn it over to Johnny Hecker, our Executive Vice President of Operations, to take a few minutes to give you greater insight into the go-to-market realignment that we announced on our last quarterly call.

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Before starting in on the sales numbers, I wanted to bring you up to speed on progress with our rollout of the ECFax program at the VA. As you recall, the program was a little slower out of the gate than we would have liked. However, there has been positive movement over the last quarter. In Q2, we successfully completed implementation of 40 VA facilities across 10 sites, which accounted for the planned initial evaluation portion of the program. I'm pleased to say that the response from the VA and the end user community has been overwhelmingly positive. We will be meeting with the VA and our partner, Cognosante, to map rollout plans now that we finished the test phase. We will have updates on those plans on our next call.

One more note regarding ECFax. There are nearly 30 governmental opportunities in the pipeline, and we're pleased with the overall progress. Given our confidence here, we've added some additional experienced sales talent to help us in partnership with Cognosante with getting these deals over the line.

I'd also like to announce that we have signed a full production agreement for Clarity with our first customer, a major provider of prior authorization services to the industry. Specifically, this customer will be using our Clarity Prior Authorization, or Clarity PA, product trained to extract discrete data from unstructured prior authorization fax documents and then through the application of discriminative AI, create a structured output that files directly into their processing system, eliminating delays and costs associated with manual processing of unstructured documents.

The technology here is particularly innovative. The customer required the ability for Clarity to extract both type font and handwritten content, a use case that we believe significantly expands Clarity's utility for our customers and further differentiates us in the marketplace. For Q2, bookings came in at just under $4 million, and the breakdown between product families was 80% fax and 20% advanced products. When you look back to Q2 2020 as a comparison, the number is down by just over $1 million, and this is a great example of a point that we've made several times in the past that bookings numbers are lumpy and subject to a disproportionate impact by 1 or 2 large deals.

To this point, in Q2 of '22, we were the beneficiaries of a large deal in that time frame. If you exclude that 1 deal, then we would actually have been up year-over-year. Further, you have pure timing issues. For example, after the quarter closed this year, we were able to sign 2 deals that we had projected in Q2 that missed by just weeks, which would have made a measurable difference in the quarter total. The point is that as we report our bookings, expect lumpiness and timing issues that impact our quarter-to-quarter booking numbers.

The initiative we announced 2 quarters ago to become more aggressive in mining the SOHO base to upsell those existing customers into a corporate product delivered over 1,000 accounts transitioned into higher value products. This result is consistent with last quarter and in line with our expectations. The overall pipeline remains strong and growing. In fact, in Q2, the sales team accelerated the rate of pipeline growth over Q1. We continue to be confident in the ability of our teams to move these deals through the sales process and, while slower than we would like, the issue continues to be 1 of timing and not of lost opportunities.

In the SOHO business, the price changes that we enacted last year to have now completely run through the entire customer base. We're pleased with the completion of our price increase rollout. Churn has slowed in the quarter to 3.57%, which is 19 basis points better than Q1, and 30 basis points better than Q2 of '22. Now bear in mind that the churn rate also includes those 1,000 accounts that I talked about earlier that were moved out of SOHO to corporate.

While churn rates have returned to historic levels, overall customer adds in the SOHO space are down, running about 20% less than pre-pandemic levels. Based on a number of factors, including the new pricing, some erosion of paid search, keyword volume, and our shift towards upmarket messaging, we believe that this is the new normal for web acquisition in the SOHO market. With that in mind, we are pleased to announce that we have brought on Board a key new leader for our e-commerce efforts, and he will be guiding our efforts as we transition from a small office, home office focus to a more integrated web marketing approach that aligns with our customers' buying motion. Buying motion is a concept that Johnny will talk about later.

On the product front, Clarity has been a central focus. In addition to the signed contract for Clarity Prior Authorization, we're calling Clarity PA, I mentioned earlier, I'm excited to say the team has also completed an early-stage release of Clarity Clinical Documents, or Clarity CD, with a specifically tuned Clarity instance designed to extract data out of clinical documents. Likewise, work has begun on Clarity RF, or Clarity Referrals, which is

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focused on data extraction for referrals. In each of these cases, we have customer interest that's driving our development efforts and look forward to bringing these Clarity products to market over the next several quarters.

On the Harmony front, I'm pleased to report that we have completed a successful proof of concept with an interested EHR prospect and are currently negotiating the potential for a production agreement. As you recall, Harmony uses both the transformative capabilities of our product set as well as the broad strength of our network to transform clinical documents in process between protocols and deliver information based on a receiver's preference. And we look at this successful proof of concept as validation of our product direction and a gauge of the potential for market demand.

Finally, we have continued to push forward our security program and have completed the workforce, jsign HITRUST, joining our other products that have achieved that level of security.

Now, as you recall, we announced a major realignment of our go-to-market organization under the leadership of Johnny Hecker, our Executive Vice President of Operations. Johnny has a long track record of success in both the digital fax arena as well as in large-scale cloud-based sales. We thought it would be beneficial to have Johnny talk in more detail about the realignment, our reasoning for taking this action and how things are progressing.

So now, let me hand it over to Johnny. Thank you.

Johnny Hecker - *Consensus Cloud Solutions, Inc. - EVP of Operations*

Thank you, John. Excited to be here today, and thank you for the opportunity to explain in a bit more detail what led to our go-to-market realignment earlier this year. As we started the process of evaluating the entire go-to-market posture of the company, we took a view that focused not on products or customer groups, but on the practices, behaviors and processes that are prospects used to purchase Consensus services.

Broadly, I call this the buying motion. And in thinking through our organizational improvements, it was essential that we both understand that motion of our customers and match our process, our selling motion to meet theirs. By aligning the go-to-market team in this way, we create a natural rhythm that meets the customer where they are and helps to ensure our selling process fits their buying process. As we examine the customer behaviors, we saw 4 distinct buying motions emerge. And while they loosely conform to customer size, there is a substantial overlap between e-commerce, SMB, what we call large accounts, and a list of name strategic accounts and partners, as you can see at the top graphic of the Customer Continuum slide.

More importantly, the characteristics of how the various customer groups prefer to buy, whether self-service, inside sales or field sales is the guiding principle we use to construct our go-to-market approach. We analyzed where leads come from, what marketing, inbound calls, outbound calling, channel, account-based marketing, trade shows, RFPs, referral, and networking.

We looked closely at how long the sales cycle takes from an immediate sale in e-commerce to sometimes multiple years with the largest companies we serve of prospect. This is largely driven by the complexity and length of the contracting process and then followed by the revenue ramp velocity. It varies from literally seconds in a click-and-accept process charged on a credit card to negotiating custom contracts over an extended period of time and rolling out our solutions in large complex organizations.

The revenue mix is on the low end, very much subscription dominated with only little incremental variable usage-based spend. We see what is typical for a SaaS and cloud model as customers grow and as consumption increases, clients might commit to a certain volume or spend but prefer a usage-based ramp and billing model. The way customers integrate with us and deploy our solutions as well as the mix of solutions we build for them changes from down to upmarket.

At the very bottom of the slide, we outline the multiple layers of opportunities we have. A one user account is oftentimes a one opportunity account. But as we move up from there, cross-sell opportunities arise to the level where we closely co-operate and co-innovate with our most strategic partners and customers. The VA is a prime example, an opportunity that first surfaced in 2019. It took multiple years to close and is now taking

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months, even years to fully ramp. With the government-specific offering, we're developing the process and unlocking new promising opportunities. All in all, these are the key determinants of our sales process and, by extension, how we organize the team.

Another key is to continue on of how our marketing efforts dovetail into our sales process. It is an important consideration to ensure that the coordination between marketing and sales is well choreographed, and that the customer buying motion is matched to the marketing campaign.

Finally, the alignment of our post-sales implementation, support, and opportunity management is likewise constructed around the buying motion. As we consider our share of wallet expansion and upsell potential, the customers vary in both opportunity potential and in how they prefer to be approached. Many grow and graduate over time creating untapped growth potential for us in our existing customer base.

With this overall dynamic understood, we recognized that our traditional organization model had to be significantly reimagined. We have to stop thinking in terms of SOHO and corporate and understand that in order to maximize the revenue potential of the Consensus solutions set, a full review of our organization and personnel was necessary. It was that review which led us to the realignment. That said, our internal operational go-to-market model will, for the time being, not change the way we report our numbers to our investors. We understand that many models have been built around the separation of SOHO and corporate. And just as today, we will continue to report our results in that way.

In addition to reshaping the organization, we recognize that it was essential to make personnel changes as well. The skill set to be effective in our new go-to-market environment required both training and experienced leadership to drive the transformation. While alignment and personnel are highly important, we also had to think through the technical piece of the operating environment, tools, reporting, metrics, analytics, the central supporting mechanisms to institutionalize these improvements and build the habits that lead to success inside the new structure.

A good amount of this work started in late Q1 and the momentum built through Q2. I think that the results from the quarter, bookings down a bit while pipeline grew tremendously, are ahead of expectations in this kind of major transition. I want to thank all of our employees, the team's response to the new operating approach, their quick ability to learn and apply the required skills, and the speed at which our leaders have learned the business and driven results is nothing short of exceptional.

Now, while we're all excited about the way our pipeline has grown, we are very aware that the real test here will be the points on the Board, close deals, ramp customers, revenue growth. These are the key targets we still have to hit. And while Q2 has shown us the potential of this new go-to-market approach, full execution still needs to be achieved. There is certainly work to do in order to finish that transition, but I am pleased with the start and our progress to date.

With that, let me hand it over to our CFO, Jim Malone. Jim?

James C. Malone - *Consensus Cloud Solutions, Inc. - CFO & Principal Accounting Officer*

Thank you, Johnny, and good afternoon, everyone. First of all, we are very pleased to announce Deloitte as our new auditors appointed in Q2 2023, replacing BDO, as [previously announced] in our 8-K filed on June 5, 2023.

Let's start with our corporate business results. Q2 2023 corporate revenue was $50.4 million, an increase of $1.5 million or 3.1% over the prior year comparable period, excluding Summit revenues, which was characterized as inorganic in the prior year. Q2 2023 over Q2 2022 corporate revenue growth increased to approximately 6% and grew sequentially from Q1 2023 by approximately 1%.

Corporate ARPA of $317 was down $38 or 11% from the prior year. Summit represented $9 or approximately 25% of this difference. The remainder of the ARPA difference, as John has noted in his opening remarks, is the timing of larger customer wins, which is lumpy on a quarter-to-quarter basis. Quarterly ARPA is certainly affected by this lumpiness.

Furthermore, in Q2 2023, the year-over-year ARPA decrease reflects a greater share of paid adds coming from SMB customers and the planned migration of SOHO customers to corporate. This strategy presents the opportunity to, 1, increase ARPA of SOHO customers migrated based upon our experience under this initiative; and secondly, upsell additional services gaining greater customer wallet share. Corporate monthly churn

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improved 1.3%, down from 1.9% for the prior year. The lower churn impact delivered a trailing 12-month revenue retention of approximately 101%, consistent with our expectations.

Moving to SOHO results. Q2 2023 revenue of $42.4 million, an increase of $0.2 million or 0.5% over the prior comparable period, exceeded expectations. ARPA of $15.69 was an increase of $1.82 or 13% year-over-year, substantially driven by the SOHO price increase program we announced over a year ago and completed this quarter. Monthly account churn declined to 3.6% compared to 3.9%, exceeding expectations. The 3.6% churn rate is approaching pre-price increase levels.

Moving to Q2 2023 consolidated results. Revenue was $92.8 million, an increase of $1.7 million or 1.8% over Q2 2022. Absent Summit in both periods, revenue growth would have been 3.2%. Reported adjusted EBITDA of $47.7 million was a decrease of $2.3 million or 4.7%, delivering a 51.4% margin. The adjusted EBITDA decline was primarily driven by planned employee-related costs and the timing of bad debt expense, which we expect to improve by year end.

Non-GAAP EPS of $1.36 beat our expectations, but was lower by $0.08 or 4% -- or 5.6% compared to the prior period. EPS difference results from adjusted EBITDA items mentioned above, plus increased depreciation and amortization expense as we continue to invest in our technology and platforms, an increase in foreign exchange impact related to intercompany balance revaluation, offset positively by interest income, lower taxes and a lower share count. We continue to build our cash position, ending the quarter with approximately $112 million in cash, a record cash balance and sufficient to fund operations and debt.

We are reaffirming full year 2023 guidance at the low end of revenue and adjusted non-GAAP EBITDA and above the midpoint for adjusted non-GAAP EPS. As a reminder, our guidance ranges are as follows: revenue, $370 million to $390 million, with $380 million at midpoint; adjusted non-GAAP EBITDA at $192 million to $206 million, with $199 million at midpoint; adjusted non-GAAP EPS, $4.93 to $5.20, with $5.08 at midpoint. Our Q2 non-GAAP tax rate and share count was 18.5% and 19.7 million share count. We are planning to file our Q2 2023 10-Q at market close on August 9.

That concludes my formal comments. I'd like to turn the podium back to the operator for Q&A. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) First question is coming from Ian Zaffino from Oppenheimer.

Isaac Arthur Sellhausen - *Oppenheimer & Co. Inc., Research Division - Research Analyst*

This is Isaac Sellhausen on for Ian. My first question is on the corporate channel and the deals that were delayed out to the third quarter. Could you quantify or put into perspective how large the deals were? And then maybe was the delay a function of sales realignment that you guys talked about or just customers delaying the buying decision?

R. Scott Turicchi - *Consensus Cloud Solutions, Inc. - CEO & Director*

Okay. So, the delay has nothing to do with the sales realignment. This is more a continuation of the large and strategic accounts. If you go back to Johnny's buying motion and continuum chart, this would be at the upper end of that spectrum -- sort of the upper quartile, if you will. And these are situations, some of which you heard, like Clarity, we've been working on for in excess of a year. So, there's different reasons why there were delays.

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I would say, generally, they fall into a couple of different categories. 1, we've noticed at that upper quartile, a slowness in decision-making generally, irrespective of whether it's the core fax service or an enhanced service like Clarity or the initial phases of Harmony. So that's just something we've generically seen. We've talked about before sort of the uncertainty of the economy and the tight labor market, particularly as it relates to the implementation of services like these is a constraint for some of those larger buyers. So that's 1 element.

Now, if you think of Clarity in particular, and you go back to some of the previous earnings calls where, to use a football analogy, we thought we were on the 5-yard line, multiple occasions, and the next quarter, the ball didn't get into the end zone, a lot of that had to do with unpacking what we're disclosing now to you an understanding about Clarity. When we first launched Clarity as a service, think about really more as a platform technology. And the vision was, we'd go out and we would be able to take all comers. What we learned through the proof of concept phase is that they really need to be [productization] to address very specific and somewhat narrow the situations.

So, the customer that really we gained traction with was involved in this area of prior authorizations, and they went through their own understanding of prior auths. They unpacked what they thought were corner cases that turned out to be very core to how their own business functions. One example is, a lot of those prior auths come in via handwriting. That was not the assumption when the process and the testing began. It was assumed by then that the vast majority was all in some [Python]. Well, as you can probably imagine, whether it's enhanced OCR or NLP, it's a lot easier to read and to learn when there are standard-type fonts, that becomes much more challenging when you start to introduce handwriting.

But we can understand that in order for this service to really deliver the value to them, it needed to be able to address the vast majority of the prior auths requests that they process. So that actually caused us to evolve the product to really take it from where it was and go into almost a 2.0. So that created a delay because the specs of that changed, and it was through that process that we then determined there are other use cases where we can narrow the functionality and that's resulted in now the recent launch of Clarity CD, and then as John hinted at in his remarks, which will not come until next year, Clarity Referrals. So there'll be the different, we call them apps, that will run on the core platform to address specific use cases.

So, there's different reasons why each of these was delayed, but certainly any of the Clarity customers fall into, I would call it, the evolution of the product. But almost all of them were affected because they're all healthcare-related by a general, I'd say, slowness in that marketplace in making decisions and commitment. Now, we're seeing that start to accumulate now. We were talking amongst ourselves before the call. We'll have a very nice pipeline to report in Q3.

But you should anticipate that these kind of customers that we talk about, these are at ramp. These are hundreds of thousands of dollars a year to in excess of $1 million. And the key there is ramp. But go back to Johnny's slide, ramp doesn't mean that just because we start to roll out in Q3 that you're going to see that kind of revenue in Q3. And in fact, our own view, and it may be somewhat conservative, is to not assume that. And that's 1 of the reasons why we've not been more aggressive on the revenue for the corporate channel for the balance of the year. We've assumed some of that will come in this year, just like there'll be some VA revenue, but we've assumed that all that revenue in the back half of the year still relative to our core book of business rather modest, maybe a little bit more than de minimis but rather modest.

Isaac Arthur Sellhausen - *Oppenheimer & Co. Inc., Research Division - Research Analyst*

Okay. Understood. And then just as a quick follow-up. On the VA rollout, could you just more broadly talk about how the implementations have gone? And then, the other opportunities that you mentioned, any color that you can give on the timing of those would be great.

R. Scott Turicchi - *Consensus Cloud Solutions, Inc. - CEO & Director*

Yes. So, the VA, and I think prudent reasons was very cautious. So they selected these 10 sites and each site can have multiple facilities associated with them. So, on average, there were 4 underlying entities, hence the 10 sites mapping to 40 facilities. And what they were interested in, I think a lot of it was a learning process for them as well. And I know, to the outside audience, it probably sounds very simple. Oh, you've got a facility, an institution, and they have a fax machine or fax machines or a server or a multifunction device that can send or receive faxes.

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Well, the answer actually is, all the above. It's not generally 1. So, 1 of the things they had to go through is, when they would query a site, what are all of the use cases by which -- and devices by which you send and receive faxes today. And so they would submit a questionnaire back to Cognosante and us. And then we go down the list and say, okay, that's already covered. Okay, you have a Lexmark multifunction device. We do or don't have an API that can work with that particular manufacturer. So the VA wanted to have the best customer experience for the underlying facilities. And as a result, there was incremental work that we did to make sure we can address not all, but substantially all of the use cases that would capture substantially all of the traffic. So, they were very diligent about that. We only would roll out a couple of sites on a 2- to 3-week basis. And as a result, this initial phase took probably about 3 months because it just ended in late July.

And so, now that acts as the template for how we start to roll out the rest of the facilities. And just sort of want to understand, there are over 2,000 additional facilities. So, the 40 only represents 2% and they weren't -- for obvious reasons, the largest 2% are probably closer to the smaller end of the spectrum of the 2%. So, it has given the VA, I think, confidence of how this can be done. And in fact, later this month and a couple of weeks, we'll be having a on-site meeting with the VA, Cognosante and ourselves to work through now how we do the next batch. Because one of the things the VA offered internally, once it became known to the facilities in the site that the service was available, they could put their hand up and ask to the early adopters. And so, a number of sites and a larger number of facilities have raised their hand, if you will, to 1 of the early adopters. So now, we want to build a process that the VA is comfortable with and that will meet those needs, but obviously on a more accelerated basis than it took through all the first 40. But that plan is still very much under development and under negotiation amongst Cognosante at the VA and ourselves, and we'll know a lot more at the end of this month.

Operator

(Operator Instructions) The next question is coming from Jon Tanwanteng from CJS Securities.

Charles S. Strauzer - *CJS Securities, Inc. - Senior MD of Sales*

It's Charlie Strauzer for Jon. Just a quick 1 for me. How have your expectations changed, if at all, in the web fax versus corporate outlook? And how has the conversation evolved over the last sort of with potential enterprise clients?

R. Scott Turicchi - *Consensus Cloud Solutions, Inc. - CEO & Director*

I missed the last part. How has the conversation changed over the -- what? I couldn't hear. You muffled.

Charles S. Strauzer - *CJS Securities, Inc. - Senior MD of Sales*

Sorry about that. How has this conversation evolved over the last quarter or so with potential enterprise clients?

R. Scott Turicchi - *Consensus Cloud Solutions, Inc. - CEO & Director*

Okay. So, on the SOHO, and I'm glad you pointed out, SOHO, as Jim mentioned, everyone mentioned, had a very good quarter, a pleasing quarter to us in that, obviously, well, not tremendous growth. It did take a little bit of growth over the same quarter of the prior year. But as we noted, this was due in large part to what we've seen over the last several quarters, which is a consecutive increase in the ARPU as the price change at various pace has rippled through the base.

So as we look forward, with the price change being complete, we don't anticipate that SOHO will necessarily be in the positive territory for the back half of the year. In fact, if you look at the math, and I endorse what John said that until our new head of e-commerce really gets his feet under him and thinks more holistically about the various marketing opportunities, I think it's safe to assume the 75,000 of gross new adds per quarter what we call the SOHO channel. And remember, we're stealing some from the SOHO channel into the SMB, that 1,000 roughly a quarter. So, I think,

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if you look at that and the fact that the price change is up about 13% and is a very tough Q3 and Q4 comp because we pushed through so much of the price change in the back half of '22, you should expect the SOHO channel to be modestly negative in Q3 and Q4 of this year.

And then, as we look at the '24, we will revisit a whole basket of opportunities, which includes how we market, may we include looking at pricing, there'll be a whole basket of things we'll look at in terms of how we think of that piece of the business, not e-commerce channel as a whole, but the SOHO customer base as a portion of the e-commerce, how do we look at that on a going-forward basis? And obviously, stay tuned, as we get into next year or closer to next year in terms of our thinking of guidance for the channel. But right now, we wouldn't back away from the guidance that we've given you throughout the year in terms of the budget for corporate, which is slightly negative this year.

And then, John, do you want to talk about the sales motion you've been seeing on the large and strategics?

John Nebergall - *Consensus Cloud Solutions, Inc. - COO*

Yes. On the enterprise side, I think we're seeing a few things. We're enthusiastic about the pipeline that we're able to build in Q2. I think that's accelerated substantially from Q1 when we were still cleaning house a little bit. And after the realignment, obviously, new sales orders coming in, you have a closer look at the pipeline and look how much potential is really in there. So we cleaned that out and then we really built up on it.

We're excited that some of the deals are closing and some of these were delayed 3, 6 months and beyond the close date that we had anticipated. And we've been reporting on this for a couple of quarters now that the decision-making is slow. So, that said, we don't see a lot of acceleration. We don't see these deals actually fall out of the pipeline. So we're not losing them, it's just that slow decision-making. Eventually, customers do decide and we bring them in, and we just need to build more pipeline to get more transactions in these larger sales motions.

But we're seeing 2 things happening. On the 1 side, I think our strategic partnerships are starting to pay out. So, we have a -- I think we reported last quarter on the AWS partnership that we're a ISV Accelerate partner of AWS. We see first deals materializing there and closing there. We have strong partnerships in the telco space. I think we sent out a press release on the Hyland OnBase partnerships. So, all of those, and there's more partnerships to come that we're working on, all those are generating larger leads in the enterprise world.

So, we're excited about what's happening. But as I mentioned in my opening remarks, obviously, we have to close those deals and ramp them up to revenue. And as you saw on the continuum side, that revenue ramp. First, you have the sales cycle, the contracting cycle, Now that revenue ramp can be several months each. So, sometimes over a year, 18 months, so it takes time. But very exciting to see that customers are moving.

R. Scott Turicchi - *Consensus Cloud Solutions, Inc. - CEO & Director*

So we'll take a question by email that came in, which is -- question is to refresh our investors' memory on how management incentives work and basically the stock component within our overall compensation program. And it's a very broad question because everybody within Consensus has equity, although it is a varying degree of their total compensation. There are about 30 or so individuals where it would be much more significantly weighted relative to the cash component. Particularly you can see in the proxy, the named executive officers like myself and John. And half of that stock for those 30 people is performance-based, and the performance criteria is stock price, it's actual stock price dollar amounts. And there's been a lot of debate, including discussion with comp consultants or what are the right metrics for using performance-based, and there's all kinds of theories. And I have to admit I don't think any of them actually hit the mark perfectly.

But our philosophy is that we want our managers or senior managers in particular to be aligned with growing the stock price. And that if the stock price grows, not only will that equity that's issued at a certain price be worth more, but in the case of the performance units, then it triggers the ability for those to vest, and we put a 10% CAGR on the stock price based on the data grant. So, obviously that has not worked as we would liked so far. But as I remind, the management team and the employees, these things play out over several years, I saw this at J2 where in 1 year, multiple tranches of equity vested because the stock went on a [tear] 1 year. And as a result, there was not only a catch-up to what I call the normal vesting, but there was actually an excess, if you will.

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So, while obviously at the current price levels, those key issues are not in the money for any of the employees, there's still time to vest. And as a result, we're looking out over in terms of that portion of our compensation, the long term. For John and myself, it actually represents 77% of our equity grant for the other employees that represents 50% and they're granted on an annual basis coming up in November. John and I took a onetime grant that holds us for about 5 years. And if somebody is interested, our first vesting price is $62.87, so roughly double what the stock price is today.

So, we all have an incentive collectively as employees of the company, as owners of the company, no matter what our ownership position of equity, and certainly those that are PSUs to do things that will move the stock in a northward direction. And that encompasses both the operational elements and also our capital allocation opportunities, which I addressed briefly in the opening remarks, we do put share buybacks in as part of that capital allocation. But we're not solely focused on buybacks. And the reason for that is, our own view of the capital markets environment, higher rates of interest and the fact that we do have maturities in '26 and '28 respectively, and in order I think to get good execution on those refinancings, it will be in our interest to refinance less than $800 million of debt.

So as a result, in some form, we look to repay or retire some debt prior to maturity, how exactly that will be done as being studied now. As I mentioned, there were some handcuffs placed on us for the first 2 years post-spin. And that was just the nature of the spin. But as we come up to the second anniversary of the spin in October, and those restrictions are loosened, that gives us the flexibility then to start looking at, might we be able to recapture some of the debt? And depending on the price, that could give us a better yield than we're currently experiencing by just investing it in relatively short and safe money market funds, where we're getting 5-ish percent.

Okay. That was the question from email. Any other questions that are live, Paul?

Operator

There were no other questions from the lines at this time, Scott.

R. Scott Turicchi - *Consensus Cloud Solutions, Inc. - CEO & Director*

Right. Thank you. And I would just thank all of you for participating in our Q2 earnings call. Few housekeeping notes. Q3, clearly, we'll be reporting sometime in November, about 3 weeks before we put our press release of the exact date. Tomorrow, we will be presenting virtually at the Oppenheimer Conference. So, some of you signed up for one-on-ones. There will be a fireside chat tomorrow. It's in our press release dated August 3. And then, on September 7, we're going to host a webinar. It will feature John and Jeff, Jeff is our CTO, to discuss artificial intelligence or AI, generally how it is used in health care today and then more specifically, how we use it both in our Clarity surfaces as well as, as we look forward, where we see NLP and AI playing a role.

We did a similar conference with 1 of our covering analysts maybe 4 to 5 weeks ago. That was well received, but it was a closed audience. So this one is opened up to anybody that is interested. There will be a press release that will go out that we'll announce it just right after Labor Day, and we'll give you all of the particulars of how to sign up and to participate. And then, as we have other conferences that come up, we will put our press releases to alert to them. And I say, if not, then we'll talk again in November to discuss Q3 results. Thank you.

Operator

Thank you. This does conclude today's conference. You may disconnect your lines at this time. Thank you for your participation.

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