07-Nov-2024

Consensus Cloud Solutions, Inc. (CCSI)

Q3 2024 Earnings Call

Copyright © 2001-2024 FactSet CallStreet, LLC

CORPORATE PARTICIPANTS

Adam Varon
Senior Vice President-Finance, Consensus Cloud Solutions, Inc.

R. Scott Turicchi
Chief Executive Officer & Director, Consensus Cloud Solutions, Inc.

Johnny Hecker
Executive Vice President-Operations & Chief Revenue Officer, Consensus Cloud Solutions, Inc.

James C. Malone
Chief Financial Officer, Consensus Cloud Solutions, Inc.

OTHER PARTICIPANTS

Jenny Shen
Analyst, BTIG LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to Consensus Q3 2024 Earnings Call. My name is Paul and I will be the operator assisting you today. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] On this call from consensus will be Scott Turicchi, CEO; Jim Malone, CFO; Johnny Hecker, CRO and 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

Senior Vice President-Finance, Consensus Cloud Solutions, Inc.

Good afternoon and welcome to the Consensus Investor Call to discuss our Q3 2024 financial results, other key information and our Q4 and full-year 2024 guidance. Joining me today are Scott Turicchi, CEO; Johnny Hecker, CRO and EVP of Operations; and Jim Malone, CFO. The earnings call will begin with Scott providing opening remarks. Johnny will give an update on operational progress since our Q2 2024 investor call and then Jim will discuss Q3 2024 financial results and Q4 quarterly and full-year 2024 guidance. After we finish our prepared remarks, we will conduct a Q&A session. At that time, the operator will instruct you on the procedures for asking a question.

Before we begin our prepared remarks, allow me to direct you to our forward-looking statements and risk factors on slide 2. As you know, this call and the 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 risk factors and uncertainties include but are not limited to the risk factors that we have disclosed in our 10-K SEC filing.

Now, let me turn the call over to Scott.

Copyright © 2001-2024 FactSet CallStreet, LLC

R. Scott Turicchi

Chief Executive Officer & Director, Consensus Cloud Solutions, Inc.

Thank you, Adam. We had another strong quarter in Q3, beating our expectations for revenue adjusted EBITDA and adjusted non-GAAP net income per share. The outperformance occurred in both channels of revenue. This, combined with our disciplined approach to cost, resulted in another quarter of excellent EBITDA performance and an EBITDA margin above the midpoint of our range of 50% to 55%. As we laid out in our Q4 2023 earnings call, our goals for this year include, first, eliminating certain costs of the SoHo channel, especially in the area of marketing to provide for stabilization of the base of revenue over time, which Johnny will address in his remarks. Two, continuing to pursue the acquisition of customers primarily in the healthcare space for our Corporate channel. Three, reviewing our overall cost structure with the goal of driving adjusted EBITDA margins north of 54%. I would note it's 54.7% for the nine months. And four, continuing the repurchase of our debt to further reduce our total debt-to-adjusted EBITDA ratio in anticipation of the first tranche maturing in October of 2026.

Our Corporate channel had the best revenue growth in six quarters. The 5.3% growth was driven by new customer additions and record usage for a quarter. The new adds came primarily through our e-commerce efforts of eFax Protect, supplemented by upgrades from our SoHo base as well as several key enterprise wins.Notwithstanding the lower ARPA of eFax Protect customers than our current average, we were still able to maintain a $310 ARPA per customer in a tight range over the past several quarters. As predicted, we continue to see additional sites from the VA rollout driving new levels of usage and revenue. In addition, we saw a return to 100% LTM revenue retention in our Corporate channel.

Our SoHo revenues beat our expectations for the quarter. The rate of decline slowed from Q2 and we expect that there will be a reduction in the pace of decline in 2025. We continue to track ahead of our 2024 budget and have tested additional marketing opportunities while maintaining a strong LTV-to-CAC. We were able to substantially reduce our marketing spend and still generate 64,000 paid adds similar to Q3 2023 and more adds than in the preceding three quarters. The combination of robust adjusted EBITDA, strong cash collections and retirement of debt allowed us to generate free cash flow of approximately $34 million. The change in free cash flow from the prior year is driven by the timing of tax payments, which Jim will address in more detail.

We were also able to repurchase an additional $31.1 million of debt in the quarter. This brings our total repurchases since launching the program in November 2023 to $187 million and reducing our outstanding total debt to $618 million or 3.2 times our trailing 12-month adjusted EBITDA and 2.9 times on a net debt basis to our adjusted EBITDA. Jim will discuss our guidance for Q4 and the fiscal year in his portion of the presentation.

However, I would like to note that Q4 usually has the fewest business days of the four quarters. And since approximately one-third of our total revenues are usage-based, this puts downward pressure on Q4 revenues relative to Q3. This year however the calendar is the most punitive as Christmas and New Year's Day both fall on a Wednesday. Based on historical analysis, we have compensated for this in the calculation of our Q4 business days. As a result, we expect approximately 61 business days in Q4 of 2024, which is one and a quarter business days less than Q4 of 2023 and approximately three and a quarter business days less than Q3 of 2024.

I will now turn the call over to Johnny to provide more operational updates.

Johnny Hecker

Executive Vice President-Operations & Chief Revenue Officer, Consensus Cloud Solutions, Inc.

Thank you, Scott, and hello, everyone. I will provide an update on operations and go-to-market for the Corporate and SoHo businesses respectively, including details on revenue, customer counts and go-to-market strategy. Q3

Copyright © 2001-2024 FactSet CallStreet, LLC

was another record revenue quarter for our Corporate business. I'm very pleased with our growth and the increased momentum resulting in another solid performance in Q3. Our revenue for the third quarter increased by approximately 5.3% compared to the same period last year, the highest rate in the last six quarters. We have reached a total of $53.1 million, up from $50.4 million in Q3 of the previous year, particularly Cloud Fax, especially in healthcare, showed solid consumption growth within our existing customer base while we were able to implement and ramp recently one new customers across the board.

Our Corporate customer count has reached roughly 58,000, the highest ever for Consensus. And I am pleased to report that Corporate ARPA has maintained flat quarter-over-quarter at $310 and well within the stable $305 to $320 dollars range for eight quarters now. Driven by automation, e-commerce and SoHo upsell to Corporate added over 3,000 customers to the overall Corporate account base in Q3, another significant increase since last quarter. Our eFax Protect service is experiencing sustained growth. To further capitalize on this momentum, we're investing in its expansion as outlined in the go-to-market strategy we presented last year. While the recently introduced in-product upsell options from SoHo to Corporate has been successful in reducing the need for direct customer interaction and driving growth, we're seeing this upsell strategy plateau after many successful quarters. Moving forward, we'll maintain this profitable program but continue to shift our focus towards e-commerce as the primary driver for acquiring small Corporate accounts.

The success and growth of Corporate accounts on the lower end of the ARPA spectrum, driven by those new customers acquired through the e-commerce channel or upsell from SoHo, continues to influence the Corporate cancellation rate. It has increased by 112 basis points year-over-year and 32 basis points quarter-over-quarter reaching 2.61% in Q3 of 2024. It is important to note that our cancellation rate is calculated on a per account basis rather than on revenue. As a result, we believe that the revenue retention metric is more relevant than the cancellation rate. Our dedication to customer retention, upselling and cross-selling is yielding positive results with a modest increase in revenue retention to 100% over the past 12 months in the Corporate channel. This is another encouraging indicator of our momentum and remarkable success in the Corporate revenue channel.

I am pleased that our go-to-market plan for 2024 is unfolding successfully. The green shoots we have previously mentioned are driving revenue growth across our entire customer base. As service utilization continues to rise, customers who have made a purchase are demonstrating a strong commitment to swift adoption.

Let me share a quick update on the VA. The implementation of ECFax at the Department of Veterans Affairs is progressing as planned. We have observed steady growth that is aligned with our projections and allows us to confidently confirm the forecast of over $2 million in revenue from the ECFax program in 2024. As we move forward, we anticipate sustained growth in the coming months and years, further solidifying the program's success at and beyond the VA. In-line with our vision for 2025, our core fax business remains our primary focus. We maintain our commitment to investing in the ongoing development and enhancement of our Cloud Fax platform. With customer satisfaction at the forefront, we are consistently working to improve the platform while ensuring our continued economic success. Clarity, which features AI technology, continues to generate significant interest among potential customers. We're actively engaged in implementing the solution for clients. Simultaneously, we're diligently addressing our increasing backlog of proof-of-concepts to ensure that all interested parties have the opportunity to experience the capabilities of Clarity.

I am now shifting to the SoHo channel. In the third quarter, the SoHo business generated a revenue of $34.7 million, a decrease from the previous year's $40.1 million. This represents a decline rate of 13.6%, which is a slower decline compared to the previous quarter. The total SoHo account base has also slightly decreased from 785,000 to 768,000 during the quarter. Despite experiencing this decline, our SoHo business manages to modestly exceed expectations, showcasing the robust strength of our brand portfolio, particularly exemplified by

Copyright © 2001-2024 FactSet CallStreet, LLC

eFax. The introduction of new first-month discounted pricing plans across several brands has proven effective in boosting revenue velocity within SoHo. Moreover, in Q3, the average revenue per account remained relatively stable at $14.88. Additionally, the cancel rate showed a modest sequential improvement to 3.38% compared to 3.49% in Q3 of the previous year.

Looking ahead, we remained focused on executing our strategy for the SoHo business, maintaining profitable stability and optimizing current operations and resources. Rather than pursuing aggressive growth strategies, we aim to leverage our existing strength and offerings to ensure the long-term sustainability of our business in this market. Our smarter ad spend strategy designed to enhance customer acquisition profitability has delivered sustained success. We've maintained a focused on automating and optimizing this program, resulting in marginal outperformance across all brands compared to our projected outcomes. The synergy between our digital advertising strategy and SCO initiatives have been instrumental in optimizing our LTV-to-CAC ratio. By integrating these channels, we have achieved a holistic and comprehensive approach to digital marketing, effectively reaching our target audience and driving profitable customer acquisition.

In closing, I'd like to provide an update on the current market conditions. While they remain less than optimal, we've been successful in navigating around the challenges and building a sales pipeline resulting in closing new customers across our customer spectrum, particularly multi-location and specialty healthcare, as well as state and local government have shown promising results. Also, some positive signs are emerging. Macroeconomic uncertainties persist. Despite these, we stay committed to our strategy prioritizing cash generation and profitability. Our go-to-market efforts will continue to focus on driving growth within the Corporate business.

With that, I want to extend a heartfelt thank you to our employees for their extraordinary commitment and to our customers and partners for their continued collaboration and trust.

And now I will hand the call over to our CFO, Jim Malone, who will provide an update about our financial results and guidance. Over to you, Jim.

James C. Malone

Chief Financial Officer, Consensus Cloud Solutions, Inc.

Thank you, Johnny. And good afternoon, everyone. In our press release and in our earnings call today, we are disclosing Q3 2024 results plus Q4 2024 and 2024 full-year guidance. We expect to file our Q3 10-Q today.

Let's go over to our Corporate business results. Q3 2024 revenue was a record $53.1 million, up $2.7 million or 5.3% versus prior year and performing better than expectations. Corporate ARPA of $310 was essentially flat with the prior quarter and in-line with the last several quarters, ranging from $305 to $320. Q3 2024 customer churn of 2.61% increased 112 basis points year-over-year and 32 basis points sequentially, primarily driven by customer churn at the lower end of the customer continuum. Normalized for eFax Protect, the cancel rate would have been approximately 2%. Notwithstanding this, these customers are net economically beneficial. I would also like to repeat Johnny's comment that our cancel rate is calculated on a per account basis. A better measure is revenue retention, which came in at 100% over the trailing 12 months, a 1% improvement sequentially.

SoHo results. Q3 2024 revenue of $34.7 million is a decrease of $5.5 million or 13.6% over the prior year and in-line with expectations. As mentioned previously, this decrease is driven by our planned reduction in advertising spend and the corresponding year-over-year base reduction due to lower paid adds. ARPA of $14.88, decreased 2.8% year-over-year as a result of the shifting to price plans with a discounted first month versus a free trial. These plans are net economically benefit. It should be noted that year-over-year paid adds were flat amid an

Copyright © 2001-2024 FactSet CallStreet, LLC

approximate 40% lower spend as we continued to optimize our advertising campaigns. Churn declined 11 basis points to 3.38% year-over-year and 2 basis points sequentially in-line with expectations.

Moving to consolidated results. Q3 revenue of $87.8 million is a decrease of $2.8 million or 3.1% over Q3 2023, again in-line with expectations. Adjusted EBITDA of $46.9 million, a decrease of $0.6 million or 1.2% over Q3 2023 was ahead of expectations and driven by lower revenue, partially offset by cost structure optimization, primarily in the area of SoHo advertising. Adjusted EBITDA margin of 53.5% was 100 basis points better than the prior-year comparable period, delivering a solid EBITDA margin amid continued cost optimization. Adjusted net income of $25.5 million is a decrease of $4.2 million or 14.3% over prior year, driven primarily by a $5.8 million non-cash foreign exchange reevaluation of intercompany balances, partially offset by lower interest expenses on the success of our bond repurchase program and lower income taxes. Adjusted EPS of $1.31 is lower than the prior year by 13.2% or $0.20, driven by the items previously mentioned and a modestly lower share count. Q3 2024 non-GAAP tax rate and share count was approximately 19% and approximately 19.4 million shares.

As mentioned in our Q3 November 2023 earnings call, we announced a $300 million three-year bond repurchase program. In Q3 2024, we repurchased $31.1 million face value for $30.6 million cash. Program to-date, we have repurchased $187 million face value for $173 million cash and have approximately $113 million bond repurchases remaining under this program. With the debt repurchases just mentioned, total debt-to-adjusted EBITDA is 3.2 times and net debt-to-adjusted EBITDA ratio is 2.9 times. We're getting very close to achieving our total debt-to-adjusted EBITDA target of 3 times.

We ended Q3 2024 with $55 million in cash, which is sufficient to fund our operations and repurchases of debt and equity. Q3 2024 free cash flow is $33.6 million versus $49.9 million in the prior comparable period. This decrease was probably primarily due to a foreign tax refund and the deferral of Q2 and Q3 2023 federal income tax payments under the California Disaster Recovery – Relief Act, which were subsequently paid in Q4 2023. Q3 2024 CapEx of $8 million is down $2 million or 20% versus the prior year.

Now, let's talk about guidance going forward here. Q4 2024 guidance. Revenues between $83 million and $87million with $85 million at the midpoint. Adjusted EBITDA between $42 million and $45 million with $43.5 million at the midpoint. Adjusted EPS of $1.14 to $1.24 with a $1.19 at the midpoint. Q4 estimated share count and income tax rate are 19.5 million shares and 19.5% to 21.5% tax rate.

Moving to full year. Our revenue and adjusted EBITDA range has been narrowed within previously provided guidance based on year-to-date Q3 2024 performance, plus our Q4 2024 guidance range. Revenues between $346 million and $350 million. Adjusted EBITDA between $186 million and $189 million. Adjusted EPS between $5.45 to $5.55. Therefore, we're narrowing the full-year 2024 revenue and adjusted EBITDA guidance while maintaining adjusted EPS range of $5.45 to $5.55. Our estimated share count and non-GAAP income tax rate are 19.5 million shares and 19.5% to 21.5% tax rate.

That concludes my formal comments. Now, I'd like to turn the call back to the operator.

Copyright © 2001-2024 FactSet CallStreet, LLC

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] And the first question today is coming from David Larsen from BTIG. David, your line is live.

Jenny Shen
Analyst, BTIG LLC

Q

Hi. This is Jenny Shen on for Dave. Congrats on the quarter and thanks for the question. I'm just doubling down on the hospital environment right now. I know the general consensus has been that it's kind of a two-sided coin with some hospitals doing better than others. Just broadly speaking, what are you guys seeing in terms of the labor and inflation trends for hospital? And also whether you think the recent election or even CMS's recent physician fee schedule will have any impact on your hospital customers if they have said anything yet so far? Thanks.

Johnny Hecker
Executive Vice President-Operations & Chief Revenue Officer, Consensus Cloud Solutions, Inc.

A

Yeah. Hi, Jenny. And thank you for the question. This is Johnny. I think it's a really good question. And you partially answered it already, right. Some hospitals are doing well. Others are struggling. I think I mentioned it in the call, right, we see the green shoots actually growing and converting. So I think we've found a way, especially in the specialty healthcare space, in the multi-location healthcare providers, where we can find customers with, let me call it, accelerated interest and conversion. So, while we still have some very large clients that take their time and we still see continued headwinds in that area, we have found ways to convert and actually ramp new customers. So, like you said, it's a diverse environment out there and some customers are really accelerating, which is encouraging. Even more encouraging that we find them and can engage with them and others continue to be slow.

From the question about the administrative change and the new rules from the CMS, we don't see any particular impact on our business at this point. I don't know, Scott, if you want to...?

R. Scott Turicchi
Chief Executive Officer & Director, Consensus Cloud Solutions, Inc.

A

No. I think you had a third question, which is about the election and any impact it might have specifically on customer acquisition. My guess is generally the answer is going to be no. Obviously, there's a lot of unknowns at this point. There's still an undecided House race. And so I think if you listen to even Chairman Powell today on the interest rate cut and his commentary going forward, two things. One, there's a lot of unknowns because we don't have a settled Congress; and two, a lot of the policies that have been talked about and may be implemented are probably still months in the future in terms of getting through, even a unified Congress and then actually getting implemented.

So, it's obviously something we will watch. There's all kinds of different pieces to it obviously but how does it affect the economy? Generally interest rates, you can see already moving around. Tax implications, there's a whole myriad of things but I think it's too early to call. But, in general, I would say that elections and the different parties that can be in control of a divided government doesn't have a huge impact on our customer acquisition, go-to-market strategy. Clearly, if things either give an accelerant to the economy or a headwind that could have an impact. But in terms of the direct correlation, I'd say it's generally weak.

Copyright © 2001-2024 FactSet CallStreet, LLC

Jenny Shen

Analyst, BTIG LLC

Q

Got it. Thank you.

Operator: Thank you. [Operator Instructions] And there were no other questions from the lines at this time. I will now hand the call back to Scott Turicchi for closing remarks.

R. Scott Turicchi

Chief Executive Officer & Director, Consensus Cloud Solutions, Inc.

Great. Well, thank you very much for joining us today. It was obviously a very busy day to report earnings. So, if any of you, in listening to the replay or reading the transcript have questions, please feel free to reach out to us. We will have probably one or two conferences between now and our next reporting period, which we'll target for the third week of February. Of course on that call, we will discuss not only the Q4 results but we'll release 2025 guidance on revenues, adjusted EBITDA and non-GAAP earnings per share as much as we've done this year. So we look forward to talking to you in the interim and then giving you that update in about three months. Thank you.

Operator: Thank you. This does conclude today's conference. You may disconnect your lines at this time and have a wonderful day. Thank you for your participation.

Disclaimer
The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2024 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.