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Acxiom Corp. (ACXM)

Q1 2018 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good afternoon, ladies and gentlemen, and welcome to the Acxiom Fiscal 2018 First Quarter Earnings Call. [Operator Instructions] As a reminder, this conference call is being recorded.

I would now like to turn the call over to your host, Ms. Lauren Dillard, Head of Investor Relations. Please go ahead.

Lauren Dillard
Investor Relations, Acxiom Corp.

Thank you, Christa. Good afternoon and welcome. Thank you for joining us to discuss our fiscal 2018 first quarter results. With me today are Scott Howe, our CEO; and Warren Jenson, our CFO. Today's press release and this call may contain forward-looking statements that are subject to risks and uncertainties that could cause actual results to differ materially. For a detailed description of these risks, please read the Risk Factors section of our public filings and the press release.

Acxiom undertakes no obligation to release publicly any revisions to any of our forward-looking statements. A copy of our press release and financial schedules, including any reconciliation to non-GAAP financial measures is available at acxiom.com. Also during the call today, we will be referring to the slide-deck posted on our website.

At this time, I'll turn the call over to Scott Howe.

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.

Thank you, Lauren. Good afternoon and thank you for joining us. In Q1, Acxiom achieved another quarter of both top and bottom line growth. Excluding divestitures and the impact of foreign exchange, total company revenue was up 6%. Top line highlights included LiveRamp, which continued to hit on all cylinders, and our ongoing progress in International.

Beneath the top line, we delivered meaningful gross margin improvement, which allowed us to fund incremental investment in Connectivity, and total company operating income was up 6% year-over-year.

Before we dive in, let me spend a minute on our outlook. We are maintaining our EBITDA and EPS estimates for the year. Our Connectivity growth outlook also remains unchanged. However, we now realize our projections for Marketing Services and Audience Solutions were too aggressive. This is disappointing.

In our Marketing Services segment, the timing of bookings will be slower than we originally forecasted. In addition, the impact of previously discussed pricing model changes will slow growth in Audience Solutions in later quarters. Given this, we now expect top line growth for the year to be between 7% and 8%. This represents a strong outlook relative to the past decade of growth at Acxiom but a reduction from our initial plan.

During my portion of the call today, I'd like to provide an update on each of our segments, and in that discussion, touch on some of the overarching themes impacting our outlook.

Marketing Services. Since we reorganized into divisions at the beginning of FY 2016, our Marketing Services segment has made significant progress. Over this period, our marketing database business, which represents over 90% of segment revenue and substantially all the profitability, has grown in eight of the last nine quarters.

Segment profits and cash flow, which we think are the right valuation metrics for this business, have also improved considerably. Most notably, operating income has increased by nearly $20 million over this period, a testament to our delivery efficiency and ongoing automation and standardization efforts.

We have four main goals in Marketing Services. Our number one goal every quarter is to maintain and delight our existing clients. This is the key to protecting our cash flow. And, on this important measure, we continue to experience strong success. During the quarter, we closed several key renewals, including renewals with two of our longstanding financial services clients.

Our second goal is to add new logos to the Marketing Services client roster. To achieve this goal, we've emphasized both new pipeline development and the conversion of LiveRamp and Audience Solutions clients into Marketing Services clients over time. These efforts are what will fuel longer-term top line growth.

While we have significant potential here, we need to win more and win faster, which will spur acceleration through the course of FY 2018. On our last call, we talked about new logo wins with Opportune and Embrace Home Loans, and in the last month, we won two more new logo deals, including a large multi-year contract with The Children's Place to help enable its personalized customer contact strategy.

This multi-year deals spans all three of our divisions and includes marketing database, third-party data, identity resolution, and IdentityLink for on-boarding and measurement. Given its marquee client roster and trusted relationships, a third goal for Marketing Services is to catalyze our other divisions, an impact that isn't directly visible in the Marketing Services results.

For example, virtually all our recent Marketing Services new logo wins have also fueled growth in our other divisions. A final goal for Marketing Services is to defend and grow its cash flows. This is the single most important measure of success for this business and we are delivering on it. Despite the top line pressure, Marketing Services segment margin was up over 300 basis points in Q1.

Our recent progress in adding new meaningful clients is cause for optimism, and this success must continue. As bookings convert to revenue, we put ourselves in a good position to exit this year on a growth trajectory.

Moving on to Audience Solutions. Audience Solutions is a business that continues to demonstrate DaaS-like characteristics, and increasingly we are tethering it more tightly together with our Connectivity or SaaS business. Given their similar operating models, we believe that over time SaaS and DaaS belong together. Both have high initial fixed costs, incredible marginal profitability, and at maturity are high-growth high-margin businesses.

Combined, Audience Solutions and Connectivity represent more than 50% of our revenue, and together are growing at 20%, with 20-percent-plus operating margins. The list of other software companies that fit that bill is pretty short.

On past calls, we've talked about shifting business models. Specifically we've said that, as our digital data business evolves, some revenue-sharing arrangements would convert to licensing models. This transition is taking place much quicker than we anticipated and will create a headwind to growth this year. For the quarter, Audience Solutions was up 3% and generated meaningful margin improvement.

We have several initiatives in place across Audience Solutions to offset some of the decline caused by the business model transition. During the quarter, we added several new data services partners including Pinterest and PushSpring.

In addition, we recently announced a new data integration with LinkedIn, allowing marketers to build segment and reach customer audiences through LinkedIn's Matched Audience tool.

In total, our data is available to support targeted advertising at over 140 online and mobile publishers, ad tech platforms and TV operators. As publishers and platforms outside of the big walled gardens become more sophisticated with their use of third-party data for targeting, we believe we are well-positioned.

Another top line growth initiative is to expand our global data footprint. During the quarter, we extended our coverage to include several new Eastern European and Middle Eastern countries. Our data products are now available in over 60 countries, representing close to 2.8 billion consumers worldwide.

We also recently launched a full suite of products in Mexico, including identity, data and collectivity solutions. As part of this initiative, we expanded our partnership with 4INFO to deliver more precise cross-channel audience targeting and measurement to the Latin American market.

With ad spend in Mexico projected to grow to [ph] $6.2 billion (09:42) by 2020, this launch enables our clients and partners to perform more effective people-based marketing across Mexico, and at the same time positions us to take advantage of the growing market opportunity in that region.

In summary, we continue to believe Audience Solutions is a long-term growth business with strong DaaS margins, but the pricing model transition will continue in the back-half of this year.

Switching gears now to Connectivity, our top goal for Connectivity is to continue to grow market share. And, as the business scales, we expect it to generate meaningful levels of bottom line improvement.

Connectivity had another exceptional quarter, and the business continues to demonstrate its strong network effects. In fact, Q1 was a record bookings quarter, and we are progressing across all our key growth initiatives.

A few highlights from the period: Segment revenue was approximately $45 million, up 44% year-over-year, a reacceleration from Q4. We signed over 40 new logo deals and now work with approximately 450 direct clients worldwide. We recently added another major agency holding company to our client roster. We now work with agencies from all six of the top holding companies and are powering identity resolution across two of them.

During the quarter, we also signed several key renewals, including our largest ever brand contract. We exited Q1 with a revenue run rate of more than $180 million, up from $170 million at the end of Q4, and up 50% year-over-year.

We continue to grow our partner ecosystem and added over 25 new integrations during the quarter, including new partnerships with Commerce Signals and Performance Horizon. We also continue to expand our existing strategic partnerships and are particularly excited by the traction we are experiencing with Google Customer Match.

People-based search is a complete game changer for the industry, and marketers are beginning to take notice. Google Customer Match has quickly become one of our most popular destinations, and we now have over 80 clients activating data against this use case and generating real results.

Clients are experiencing a meaningful increase in ROI by doubling click-through rates and improving return on ad spend by as much as 70%. Moreover, marketers who pair Google Customer Match with the IdentityLink data append feature can further improve their ROI by deterministically matching more of their CRM audience to their search campaigns.

In fact, marketers leveraging this feature are able to target up to six times more customers compared to using Customer Match alone. The Finish Line case study, which Google recently published, is a powerful example of this use case. Looking to reengage with past customers, Finish Line leveraged Google Customer Match to generate an increase in both clicks and reach.

Partnering with LiveRamp, Finish Line was able to increase its match rates by 2x, improve its click-through rate by 235%, and generate a 70% higher return on ad spend.

One of our top imperatives this year is to establish an identity currency for the ecosystem. On our last call, we discussed the launch of the bid-stream consortium and we are making good progress with AppNexus and MediaMath to get it off the ground.

In addition, we recently announced the official launch of IdentityLink for publishers, providing publishers with a people-based monetization platform, and allowing marketers to extend their people-based marketing initiatives across all publishers, large or small.

Over 200 publishers are now using IdentityLink, which unifies our identity resolution capabilities with the Arbor and Circulate acquisitions. If we continue to execute, we believe these initiatives will increase our match rates, improve our cross-channel capabilities, and accelerate our ability to expand internationally.

Our momentum leaving Q1 is strong and the proof points are evident. We believe this is a network business where the value grows exponentially with scale. Our progress to date has been very encouraging, and we believe that if we continue to execute across these dimensions and scale intelligently, we are well positioned for continued business success in FY 2018 and beyond.

Finally, let me talk briefly about International. Under Warren's leadership, we are making great progress outside of the U.S. Our International business again was a bright spot for the company. In the U.K. and France, LiveRamp continues to gain good traction, and our pipeline remains strong.

We recently signed new onboarding deals with two large automotive manufacturers, and we now have approximately 10 clients leveraging Google Customer Match in Europe. We also are making good progress building our publisher network and to date have extended over 150 publisher contracts to include the EU.

Just last week, in partnership with the Adobe Experience Cloud, we announced the launch of Connected Spaces in Europe. Connected Spaces is a global solution designed to deliver more relevant customer experiences at retail, travel and leisure locations such as airports, malls, sports stadiums, concert arenas and resorts.

Powered by our capabilities in identity resolution and marketing database services, this solution enables locations to better recognize and engage with the thousands of customers coming through their doors.

Heathrow Airport, which is the single largest retail center in the U.K., is a great early example. By arming its vendors with better data and insights, Heathrow can deliver more relevant communications and offers to its customers resulting in an increase in spend of up to 25% for engaged customers.

In APAC, we closed a new data and connectivity deal with Nine, a top Australian publisher. Clients can now onboard their first-party data and leverage our third-party data to reach consumers across the Nine digital network. And lastly in China, we signed a new connectivity partnership with Baidu, rounding out our existing partnerships with Alibaba and Tencent.

Before I conclude, I'd like to quickly touch base on our business separation and portfolio readiness efforts. This is a topic that generated a lot of questions following our last call. I am pleased to report that our business separation is nearing completion, and we expect our one-time spend to drop considerably at the end of Q3.

Let me remind you why we did this work. As we sit here today, we like the shape of our portfolio. Each of our businesses is a leader in its respective sector, each also catalyzes the others, and we believe each has ample room to grow and improve.

That said, since arriving at Acxiom, I've consistently pushed for clear lines of sight into each of our businesses so that we can make more effective investment, operating and portfolio management decisions. Rather than be constrained by the past, we want to be prepared for the future. This is simply the next logical step in that effort so that we maximize our strategic flexibility and are never structurally limited in what we can do to maximize long-term shareholder value.

We are now reaching a place where our portfolio has clean standalone financials, clear accountabilities and true optionality, which we fundamentally believe is the right way to run our portfolio.

In closing, while we certainly have work to do in each of our divisions, I remain confident in our business and the steps we are taking to generate even greater financial success. Thank you again for joining us today. We look forward to updating you on our progress in the quarters ahead.

With that, I will now turn the call over to Warren.

Warren C. Jenson

Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

Thanks, Scott, and good afternoon, everyone. In my portion of the call today, I'd like to mention a few highlights, then run through our results, and finally update our guidance for FY 2018. For the quarter, revenue was up 6%, marking the seventh sequential quarter of 5-percent-plus growth. Gross margin was 50%, expanding close to 500 basis points. Gross margin was also up in every segment.

Connectivity had an exceptional quarter. We exceeded our bookings target and made great progress against our key growth initiatives. International revenue was up 15%, marking the seventh consecutive quarter of growth. International Connectivity revenue increased by more than 50%, driven by strong growth in Europe.

During the quarter, we refinanced our debt, giving us more flexibility and over $30 million of added near-term liquidity. All that said, we're disappointed to lower our top line guidance for the year. This reduction is primarily driven by reduced near-term bookings expectations in Marketing Services, and to a lesser extent by a slightly lowered outlook for Audience Solutions.

That said, our framework for value creation remains intact. In Connectivity, both our top and bottom line guidance remain unchanged, and in Marketing Services and Audience Solutions, we are maintaining our EBITDA outlook for the year and our bottom line guidance.

In summary, a solid quarter, no change to key valuation metrics but a lowering of our short-term top line expectations for Marketing Services and Audience Solutions. That said, absolutely no change in our enthusiasm for our long-term opportunity.

Now onto the first quarter, starting with slide 5, our summary financial results. First, GAAP: Total revenue was down 1%. Gross profit was $99 million, up 7%. And, gross margin improved 360 basis points to 46.4%.

Op loss for the quarter was $6 million compared to operating income of $8 million, and GAAP loss per share was $0.02 compared to earnings per share of $0.05 a year ago.

Next, our non-GAAP results. Adjusted revenue was up 6%. Gross profit was $106 million, up 9%. And gross margin improved 480 basis points to 50%. Operating income was $22 million, up 6% year-over-year. And earnings per share were $0.14 as compared to $0.15.

In Q1, our tax rate was 40%. Excluded items totaled $28 million, including stock-based comp of $15 million, intangible asset amortization of $6 million, and business separation related spend of $7 million.

Slide 6 highlights our revenue results as-reported, and slide 7 adjusts for the sale of Acxiom Impact, the Australia transition and FX. Adjusted revenue was up 6% in the quarter. In the U.S., revenue as-reported was down 1%, revenue adjusted for the Impact divestiture was up 5%, driven by continued strong growth in Connectivity.

International revenue as-reported was up 2%, and adjusted revenue was up 15%, driven by our performance in Europe. Most notably a strong quarter for Connectivity in France where revenue increased by more than 200%.

Our match network in France is now greater than [ph] 15 million (23:42) with match rates in excess of 40%. Similarly in the U.K., our match network is also more than [ph] 15 million (23:52). In Europe, we recently announced a partnership with Google Customer Match, and we're excited the two of our launch customers are Samsung and Heathrow Airport.

Now turning to slides 8 through 10, our segment results. First, Marketing Services. Revenue as-reported was down 17%. Revenue adjusted for Impact was down 6% due to softness in both marketing database, and strategy and analytics.

Please remember that in a year ago quarter, we reported $3 million of one-time project-related revenue. In addition, we are now feeling the impact of price compression associated with a few large renewals. This pressure will continue to impact our top line throughout fiscal 2018.

Gross margin improved modestly to 34.2%. Segment income was $20 million, and segment margin improved 320 basis points to 21.6%, driven by productivity in the U.S. Adjusted EBITDA was $26 million, down 7%. And, EBITDA margin improved to 29%.

As a reminder, in the appendix to our slide-deck, we have included a historical view of Marketing Services, excluding Impact.

Slide 9, Audience Solutions. Revenue was up 3%. This represents the seventh consecutive quarter of growth. Revenue from our digital publisher and platform partners was approximately $18 million, up over 70%. Again as a reminder, our digital revenues and corresponding growth rates will be pressured as a result of transitioning pricing models. We expect this transition to noticeably impact our digital revenues beginning in Q3.

Gross margin improved 550 basis points to 62.3%, driven by higher revenue and operational cost savings in both the U.S. and International. Segment income was $29 million, up 14%, and segment margin improved 370 basis points. Adjusted EBITDA was $33 million, up 8%, and our EBITDA margin was 44.2%, an improvement of 230 basis points.

Slide 10, Connectivity. Revenue of $45 million, grew 44%, driven by acceleration in both the U.S. and in Europe. During the quarter, LiveRamp added over 40 new logos. Gross margin expanded 480 basis to 61%. Segment income was approximately breakeven as we continued to invest in product and sales and marketing. Adjusted EBITDA was $2 million, a modest improvement over the prior year.

Next, please turn to slide 11. For the quarter, operating cash flow was $5 million, compared to $1 million in the prior year. This increase was primarily driven by higher adjusted cash earnings. Free cash flow to equity improved to negative $6 million, compared to negative $22 million in the prior year. Both periods were impacted by incentive comp payments.

On a trailing 12-month basis, operating cash flow and free cash flow to equity were up 17% and over 900%, respectively. During the quarter, we also refinanced our debt. Our new facility consists of $600 million revolver, of which we have drawn $230 million to repay our previous debt balance. The interest rate is similar to our previous arrangement. With this facility, however, there is no quarterly debt service, resulting in a liquidity benefit of $30 million per year.

Business separation. Before jumping into guidance, let me address our spending this quarter associated with business separation. This was obviously a big quarter and we had a lot going on. There are three specific questions I'd like to answer today.

First, why does it cost so much? In short, it's complex to create separate operating units that can stand-alone when divisions have operated together for decades. Consider that, several tangled activities must be taken apart and then reconstructed independently. This is particularly true in functional areas like IT and G&A.

Next, hundreds of key business processes have to be mapped and then remapped into a new process. As an example, think about order entry, delivery and customer service. Asset ownership needs to be determined. Historical financials and auditable schedules researched and prepared. Operating intercompany agreements must be drafted, and the list goes on from there.

Next, what will we get when we are finished? Separate auditable financial statements including balance sheets, operating and lasting intercompany agreements, increased clarity, heightened accountability and stronger capital ownership, and lastly optionality. Specifically if the time comes that a divestiture or strategic partnership makes sense, we have the capability to act on that opportunity expeditiously and then complete the arrangement within a reasonable timeframe.

Third, when will we be finished? We expect to be in a position to complete this work sometime in the third quarter. In summary, this is a lot of work, but we are near the finish line for this important phase of our journey. We believe this is the right way to run our business and the right thing to do for our shareowners.

Now onto guidance. Please turn to slide 12. As a reminder, our guidance excludes items including non-cash stock compensation, purchased intangible asset amortization, restructuring charges and separation costs. We now expect total revenue of between $920 million and $930 million as compared to our prior guidance of approximately $945 million, GAAP loss per share of approximately $0.06, and adjusted EPS to be roughly $0.80. We have included our expected revenue phasing on slide 13, which remains consistent with the phasing we provided on our last call.

Next, let me provide some additional perspective on our segments. Connectivity: Our segment guidance remains unchanged. We continue to expect revenue growth to accelerate and meaningful margin improvement. Audience Solutions: Our bottom line guidance remains intact. We continue to expect margins to be flat. In addition, there is no change to our outlook for EBITDA.

We are, however, slightly lowering our full-year top line expectation. We now expect Audience Solutions revenue to be up low to mid-single digits due to transitioning digital revenue models.

Marketing Services, here, our bottom line guidance also remains intact. We continue to expect segment income to increase by single-digits. In addition, our outlook for EBITDA remains unchanged. That said, we now expect revenue to be down low to mid-single digits. As mentioned, this is a result of lowered near-term bookings expectations. While we would never discount a reduction in our top line guidance, there are many positives in this business. Most notably, we're winning new clients, we are innovating, and we expect to generate even higher returns this year, higher gross margins, and expanding operating and EBITDA margins.

To reiterate and elaborate on a few other items, for the year, we now expect CapEx to be approximately $65 million, down from $70 million. We expect stock-based comp to be roughly $64 million. As a reminder, over 40% of this expense is associated with acquisitions.

For a tax rate, we recommend you continue to use 40%. We continue to expect our share count will be approximately 83 million. This share count assumes no buyback.

We now expect one-time expenditures to be roughly $15 million. These expenditures are entirely associated with business separation. We expect restructuring charges of roughly $5 million in Q2 associated with further real estate consolidation.

With that, let me close with four final thoughts. First, Q1 was a solid quarter and we are in a strong position to deliver our bottom line commitments for the year. While we are disappointed to lower our revenue guidance, our valuation framework is intact. Connectivity is off to a great start, and our EBITDA outlook for both Marketing Services and Audience Solutions remains unchanged. We are innovating and leading. Our industry-leading approach to connecting the digital ecosystem continues to build momentum. Finally, and most importantly, we remain enthusiastic and confident in our long-term opportunity.

Thank you for joining us today. Operator, we will now open the call to questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from the line of Bill Warmington with Wells Fargo. Your line is now open.

William A. Warmington
Analyst, Wells Fargo Securities LLC

Q

Good afternoon, everyone.

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

A

Hey, Bill.

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.

A

Hey, Bill.

William A. Warmington
Analyst, Wells Fargo Securities LLC

Q

So, I wanted to start out by asking about Marketing Services. What are you seeing in terms of the bookings trends, and how long do you think it will be before you get that to a breakeven growth level?

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

A

Bill, I'll go ahead and start, and then Scott can jump in. I think the one thing that we wanted to start off with everybody on the call is, there are a lot of positive things going on and have been going on for several quarters in the business. Obviously, we don't like the fact that we're taking revenue guidance down and that some of the bookings trends have shifted out. The good news is that, we are winning clients, and that our guidance is not being impacted because we have lost clients. In fact, we are winning clients.

What we did see though is, as we sat down to prepare our projections at the end of last year, we reviewed our backlog, we looked at the timing of bookings and made certain judgments. As we got to the end of the first quarter and looked at our bookings in the first quarter and then met with our sales teams and looked at expectations for the second quarter and third quarter and beyond, it became clear that our original assumptions were too aggressive. And, we felt we had to make a call to reduce our revenue expectations for the full fiscal year.

So, what the case was, was that, we were too aggressive in the timing for those bookings. It was not about a projection of losing clients. In fact, it was simply a matter that we were too aggressive in our assumptions relative to the timing of bookings. Scott, anything to add? Go ahead, Bill.

William A. Warmington
Analyst, Wells Fargo Securities LLC

Q

I was going to ask a clarifying question, which was, are you seeing the softness more in the marketing database side or more on the consulting and analytics side? Or is that not the right way to frame it?

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

A

[indiscernible] (37:22) that revenue is marketing database, and it's over 100% of the profitability. So, that's where the softness is. And just to put things in perspective, Bill, if you look at the last few years in this business, I think we split into divisions, we're coming up on the three-year mark, right. And if you look at 2015 to 2017 marketing database in the U.S., it went from $336 million to $360 million. So, that business is growing. And of the last nine quarters, marketing database has grown eight of the last nine quarters.

And importantly, if you look at our margins and operating income, which is where I think we put the most focus, our operating margins are up 500 basis points or over 20%. And, our operating income is up $18 million. In 2015, it was $62 million. Last year, it was $81 million. So, that's growing at a CAGR of 14%. And we're winning clients, Embrace, Opportune, The Children's Place. So, the takeaway for me is that, I remain optimistic about this business. We're disappointed in our bookings timing, and we need to pull more of these across the finish line such that we can end the year with the wind at our back.

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.

A

And, Bill, let me just add to your question because I think it's important for everybody. If you look at the next several quarters, I think Q2, Q3 look a lot like Q1 on the top line. Q4, you could start to see things ease up as the comps start to get – just look better and we start to work through some of the price compression that we felt. So, Q2 and Q3 are going to look a lot like Q1.

William A. Warmington
Analyst, Wells Fargo Securities LLC

Q

For specifically Marketing Services?

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.

A

Specifically Marketing Services, yes.

William A. Warmington
Analyst, Wells Fargo Securities LLC

Q

Got it.

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.
A

And just to add a final bit of color on that, and I think we've talked about this before. But, part of the growth trends are due to price compression from the fact that, over the last couple of years, we did a really good job of renewing all of our top clients. The good news is, from where we sit right now, all of our top 10 Marketing Services clients are now under contract through at least year-end. So, there's no other significant renewals happening right now.

William A. Warmington
Analyst, Wells Fargo Securities LLC
Q

And then a follow-up question on the Audience Solutions piece of the business. In terms of the transition to the new revenue model, it sounded vaguely reminiscent of the transition we went through in the AOS LiveRamp going from the gross media spend model to the subscription model. But I just wanted to ask a little detail there in terms of what's happening there, why that's happening now. You mentioned that it should start in Q3. It's when you really see the impact. And, how long before we anniversary that impact? Is it relatively short or long?

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.
A

There are several things, Bill, we're not going to be able to completely answer your question, because today we're not going to give guidance going into FY 2019 obviously. One of the things that we've tried to do and will continue to do is to tell everybody what we see well ahead of the quarter in which it happens. And so, we felt it important to let everybody know what we're seeing relative to timing in Q3. So, that's why we brought up – that's why we're bringing it up. So, in terms of the first quarter where you're going to see a major impact, it's going to be Q3.

Now, as to the question of how long will it take to anniversary the impact, well, we have a lot of growth initiatives going on inside of Audience Solutions to help offset some of that impact, and I'll name a few. First of all, global data, or data Scott mentioned. This is now available in 62 countries, and our team in the U.S. is working with every one of our teams globally in order to make our data available to existing and prospective clients.

Today, in the digital channels, our data is available in over 140 different digital locations. A year ago, I believe the number was something like 70, and two years ago, it was zero.

Third, everyday there are new use cases being made available. And, the pressure that we are feeling, I want to reiterate, is very isolated. It is concentrated, and the concentration is pinpoint concentration. But the pressure and the trend in the use of data is a global phenomenon that is continuing upward.

Every digital publisher, digital platform and company are increasingly using data in their marketing and taking advantage of the skill sets that we can bring to the table. So, we think the pressure broadly is in our favor, but the pinpoint pressure and concentration of that pressure is significant. It is absolutely worthwhile to bring up on this call because it will be significant in Q3, and we wanted everybody to be aware of it.

William A. Warmington
Analyst, Wells Fargo Securities LLC
Q

All right. Well, thank you very much.

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.
A

Thank you.

Operator: Your next question comes from the line of Brett Huff with Stephens. Your line is now open.

Brett Huff
Analyst, Stephens, Inc.

Q

Thanks for taking my questions. One is a product question, and Scott, I think you mentioned it. I'm not sure this is the right number, about 25 people. I think that was the data co-op business. Can you give us some more insight on that? Its one thing that we get a lot of questions from investors on, and if this is really kind of a big part of the network effect that you hope that you can establish. Can you give us an update on that?

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.

A

Yeah. Just to clarify your question, are you asking about people-based programmatic, or are you talking about Smart Reach?

Brett Huff
Analyst, Stephens, Inc.

Q

I was talking about Smart Reach but I'm happy to hear about both.

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.

A

Yes, so let me start with Smart Reach. So, we now have over 80 clients participating. Our recommendation to any new client to the franchise is that, they have to do this from the get-go, because as we've talked in the past, the incremental match rates that we see can be up to 30%. In some cases, more.

So, this is a really strong differentiator for us, and what good is having a lot of segmentation information and targeting capabilities, if you can't actually apply them to the audiences you see. So Smart Reach helps people reach more consumers regardless of what channel they use, and adoption continues to increase there.

On the people-based consortium, I will tell you that, that is moving as fast as any development in the industry that I've been involved with over the last 20 years. Once we announced it, we had probably a dozen inbound phone calls of people asking if they could participate as well. Dave Yaffe who came over to us from Arbor, he is just an absolute tech superstar. He is leading the charge from our side there. We haven't launched that yet, but I think that will happen over the next quarter or so.

And you know like Customer Match, I'm not sure that we'll see kind of near-term revenue benefit from this as much as we'll see this attract new partners to our portfolio and just increase use rate of our LiveRamp pipes but we're very bullish on this.

Brett Huff
Analyst, Stephens, Inc.

Q

Okay. And then, I think there is a question for Warren since you went through the LiveRamp numbers. I think accelerated to 44%. In the last call, I think you said, about 50% was the annual expectation for the growth rate. You said, that was still in the cards. Is that still the right number to think about?

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

A

Yeah. What we've said is, we said, growth would accelerate, and then we said, it could be as much as 50%. I would say, our guidance is the same. What we're sticking with is growth will accelerate. It could be as much as 50%, but our guidance is, our growth will accelerate, Brett.

Brett Huff
Analyst, Stephens, Inc.

Q

Okay. And then last question, you said – you mentioned CapEx is going to be a little bit less than you thought. Where are we trimming or what are we prioritizing differently, and kind of give us some insight into that?

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

A

Most of the prioritization is coming out of, I'd say, out of either what we're doing corporately or in Marketing Services to a lesser extent than in Audience Solutions. If you look at the first quarter where we're increasing CapEx and where the dollars are going as to where the growth is, which is in LiveRamp, as we continue to build capacity and growth.

So, it's really about being more efficient in the core. One of the things that has allowed us to really drive a tremendous amount of productivity is what we've been doing in IT. Our entire IT team, who is led by Janet Cinfio, has just done a terrific job working with each of the divisions to take cost out, drive productivity but at the same time drive a much higher level of performance than we've enjoyed historically. And with that, we're also looking for ways to trim CapEx, and that's just benefiting everyone.

Brett Huff
Analyst, Stephens, Inc.

Q

Okay. Great. That's what I needed. Thank you.

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

A

Thank you.

Operator: Your next question comes from the line of Dan Salmon with BMO Capital Markets. Your line is now open.

Daniel Salmon
Analyst, BMO Capital Markets (United States)

Q

Hey, guys, good afternoon. I guess my question is around – the first question around the pricing pressure on the database side. How much of that is related to secular change across the industry versus perhaps competitive issues. We've seen, for example, Epsilon sort of revamp its approach to the market there lately. But, I'd just be curious on sort of individual competitive issues versus secular.

And then, Warren, could you just maybe spend a little bit more time explaining the transition of the pricing models that is driving the pressure in the digital revenue on Audience Solutions, maybe just sort of step-by-step through why that specifically is resulting in a lower guidance? Thanks.

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.

A

Yeah. Dan, on the pricing pressure, I think it is entirely what I would call typical technology trends, very consistent with everything that we've seen over the last 20 years. I mean, it's essentially Moore's Law for technology that, anytime something comes up for renewal, clients expect you to get more efficient. And, you see that in our pricing. The good news is, we've also carried that through into standardized, modularized architecture and more efficient delivery. So, we've more than compensated for that in the bottom line.

So, I don't see anything different than I've seen since I've joined Acxiom. And again, the good news is that, we've been able to secure all of our major renewals over the past few years, the big ones, and I think we're in a good spot for the rest of this year.

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

A

And then, Dan, let me try to explain. I guess, the question is, what changed and why that's causing us to slightly lower our guidance? Again, I want to iterate, the pressure that we're seeing is highly concentrated, and the best way for me to articulate concentration is to just call it pinpoint concentration.

And presume that we have a wonderful relationship and a big global relationship where we're feeling this pressure. Nonetheless, we are going to feel real revenue pressure in several elements of our relationship.

In terms of our planning, we had a phased approach built-in, and it became clear during the first quarter that, that phased approach was going to be accelerated. And so, the slight revision to our guidance is reflective of more an accelerated approach as opposed to a phased approach that we had built into our planning in May. But again, that's a slight revision to our guidance, nonetheless, a revision.

Daniel Salmon
Analyst, BMO Capital Markets (United States)

Q

Okay. Thank you.

Operator: [Operator Instructions] Your next question comes from the line of Kip Paulson with Cantor Fitzgerald. Your line is now open.

Kip Paulson
Analyst, Cantor Fitzgerald Securities

Q

Hi. Thanks for taking my question. Just a couple from me. First, could you just remind us what your thinking is on the total addressable market for the Connectivity or LiveRamp business, how much addressable ad spend, how many thousands of clients can you target, and how many potential integration partners? And then I have one follow-up?

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.

A

Yeah. So, this is Scott. There have been some studies out there that have pegged the addressable market in the billions. Our belief is that it's significantly higher than that. We think we're riding a secular trend here that companies who have been successful in recent years, in many cases have been very successful because they've done a good job of ingesting data, determining what it means, and utilizing it for their business advantage. Well, imitation is the most sincere form of flattery, as the saying goes. And, we believe that's becoming a secular wave.

So, anything that can be powered with data, from advertising at any touch point whether that's search or site personalization, television, addressable radio, to things like customer interactions over a call center or point-of-sale and retail, all of those touch points, all of those customer interactions within the marketing world, we think will be more effective when powered with data. That's why we've worked so hard to build our grid of activation partners.

Longer term, you heard me talk a little bit about this in the last call, we also think there is an opportunity for us to expand beyond marketing, not in a weird way, but in a way that is driven by our clients at their request because they're doing things with marketing and they're saying, hey, you have data that can power other decisions for me, could you extend your capabilities into these areas?

So, you don't have to do or play around with back-of-the-envelope math too much to say, what happens if you take 0.5% or 0.10% of all advertising? Well, that becomes a much bigger number.

And, if you expand that to all of commerce, it becomes an even bigger number, and then if you do some adjacent sectors, again it becomes a much, much bigger number. So, we think long-term the TAM is in the tens of billions, but obviously the market – we're building the category and it will take time for that true market to develop.

Kip Paulson
Analyst, Cantor Fitzgerald Securities

Q

Okay. Great. And then one other question I had was, I just wanted to get your thoughts on Apple's Intelligent Tracking Prevention or ITP, which is coming to Safari this fall. It apparently tries to block third-party trackers from capturing cross-site browsing data, and when combined with other efforts, to block third-party cookies. Just curious what impact or any you see from these developments on your business?

Scott E. Howe
President, Chief Executive Officer & Director, Acxiom Corp.

A

Yeah. We don't anticipate there will be one. I mean, it's something we'll watch closely. But remember, we resolve everything to an individual and we use a federated group of permissions. Our clients are collecting permissions on their websites. And so, we believe our identity resolution is much deeper than what Apple is eliminating here.

That said, I know that there are people in the ecosystem who rely primarily on cookies that will be impacted by this. But, our initial analysis suggests that, this isn't going to have a material impact on us.

Kip Paulson
Analyst, Cantor Fitzgerald Securities

Q

All right. Great. Thanks. And just one more, if I could. Gross margins expanded nicely. Are there any changes to your target gross margin expectations for any of your segments after this quarter?

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

A

We'll be giving, I guess, again we're not to get into FY 2019 today. The impact of a reduction in first party in terms of digital data could impact gross margins in Audience Solutions, but overall as other sources of digital revenue, as those grow, should help to offset that. But, other than that, no changes.

Kip Paulson
Analyst, Cantor Fitzgerald Securities

Q

Got it. All right. Thank you.

Operator: And there are no further questions at this time. I'll turn the call over to Warren Jenson for closing remarks.

Warren C. Jenson
Chief Financial Officer, Executive Vice President & President - International, Acxiom Corp.

Terrific. Again, we want to thank everybody for joining us today. We're pleased to report another solid quarter. Again, I would just reiterate, we believe we're in a very strong position to deliver on our bottom line commitments for the year.

Today, we are disappointed to lower our revenue guidance, but at the same time, we believe our valuation framework is intact. Connectivity is off to a great start. And our EBITDA outlook for both Marketing Services and Audience Solutions remains unchanged. We're innovating and we're leading, and most importantly again, we would reiterate that, we're both enthusiastic and confident in our long-term opportunity.

Thanks a million for joining us today. We look forward to talking to you over the next few days.

Operator: And this concludes today's conference call. You may now disconnect.