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PRESENTATION

Operator

Good day, and welcome to the Blackbaud 2015 fourth-quarter and year-end conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mark Furlong, Director of Investor Relations. Please go ahead, sir.

Mark Furlong *- Blackbaud, Inc. - Director of IR*

Good morning, everyone, and greetings from Charleston, South Carolina. Thanks for joining us today on Blackbaud's 2015 fourth-quarter conference call. Today, we will review our fourth-quarter and year-end financial and operating results, provide commentary on our performance in the context of our five-point growth strategy, and discuss our plans for 2016, including financial guidance for the year and updates to our long-term aspirational goals. Joining me on the call today are Mike Gianoni, Blackbaud's President and CEO; and Tony Boor, Blackbaud's Executive Vice President and CFO. Mike and Tony will make prepared comments, and then we will open up the call for your questions.

Please note that our comments today contain forward-looking statements. These statements are based solely on present information, and are subject to risks and uncertainties that could cause actual results to differ materially from those projected in our forward-looking statements. Please refer to our SEC filings, including our most recent annual report on Form 10-K and the risk factors contained therein, as well as our periodic reports under the Securities Act of 1934 for more information on these risks and uncertainties, and on the limitations that apply to our forward-looking statements.

During this call, we discuss non-GAAP organic revenue growth, which we believe provides useful information for evaluating the periodic growth of our business on a consistent basis. Details of our methodology in calculating non-GAAP organic revenue growth can be found on the Investor Relations section of our website at www.Blackbaud.com. Also please note that a recording and transcript of today's call, as well as our quarterly investor materials, will be archived on the Investor Relations section of our website.

Before I turn the call over to Mike, I would like to communicate our upcoming investor relations activity. During the first quarter, our team will be meeting with investors in Denver, Kansas City, Baltimore, Philadelphia, Boston, London, and attending the Stifel Executive Summit March 9 through the 10 in Streamsong, Florida. Please reach out to Investor Relations if you are interested in connecting at one of these events.

I am now pleased to turn the call over to Blackbaud's President and CEO, Mike Gianoni.

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Thanks, Mark. And thank you, everyone, for joining our call today to report on our fourth-quarter and year-end results for 2015. We have a change in our Investor Relations team, with Mark Furlong now leading our investor relations effort. Mark was a part of our IR function this past year, played a key role in our last two investor days, and was previously a part of our corporate [FTNA] team. His knowledge of the Company, our financials, and experience in investor relations will prove useful to analysts and investors that are following and evaluating Blackbaud. With this announcement, Jagtar Narula, who was previously Vice President of IR and Business Strategy, is now fully dedicated to strategy as Vice President of Corporate Strategy and Business Development, working under Charlie Cumbaa.

I would like to begin by mentioning that we had a very successful investor day in December. We provided an update on our strategy to accelerate performance and deliver increased value to our shareholders. The webcast transcript and presentation from our investor day on December 3 is archived and available on the Investor Relations section of our website. I communicated three key messages in my investor day session: number one, that Blackbaud is the market leader in a large and growing market; number two, we have a highly differentiated position, with a comprehensive solution set and domain expertise; and, number three, we have a clear five-point growth strategy that we are executing against -- more on that in a moment.

I am also pleased to share with you that we will once again hold investor day in 2016. In a response to investor feedback, we will be conducting the event in conjunction with our annual user conference, bbcon, this October in Washington DC. We believe the combination of these two events will provide an excellent opportunity for the investor community to better understand our solutions and engage with our customers to see firsthand the value that Blackbaud is delivering. If you are interested in attending, please contact Investor Relations.

Now let's turn to our performance in the fourth quarter and full year. We continued to expand our market leadership position, we further integrated and added to our strong solution portfolio, and we continued shifting the business to one driven by recurring subscription revenue. Tony will provide more financial performance detail, as I will cover the highlights. As usual, I would like to provide an update in the context of our five-point growth strategy. So let's begin.

The first of our five strategies is what we call integrated and open solutions in the cloud. This strategy is centered on innovation, quality, and integration of our broad solution portfolio. The announcement of Blackbaud SKY capabilities and the release of Raiser's Edge NXT, Financial Edge NXT, are prime examples of Blackbaud executing against this strategy in 2015. And, it is important to note that we delivered on our original 2014 commitment to release the NXT solutions in the third quarter of 2015.

Our NXT solution line leverages the full power of Blackbaud SKY, including advanced application services, infrastructure services, and development operations that allow us to deploy new features and functionality at a high velocity, with a record quality and availability along the way. In just a few short months, we have seamlessly delivered hundreds of releases in Raiser's Edge NXT that provide more function and value for our users.

Additionally, we believe our expertise around data, analytics, and business intelligence will significantly enhance our customer's fundraising capabilities and extend the competitive advantage of our solutions. [Fancher] College, a Raiser's Edge NXT customer, is a great example. The capabilities NXT provides accelerated their program development plan by five years. They're particularly excited that NXT is an integrated solution for the entire organization, which they believe will lead to greater program efficiencies and outcomes.

We are carrying the user experience for specific roles in the organization which is very unique. To date, we have introduced the Fundraiser role, Executive Director role, and a business intelligence capability called nonprofit intelligence, with additional roles on our roadmap for future deployment. In 2015, we held events in major cities across the country to showcase our solutions. These events are designed to feature the advantages of our solutions, provide a look into the future by sharing product roadmaps, and communicate the return on investment for our customers. We ended our 2015 roadshow tour in New York City, drawing our largest crowd of the year. In 2016, we will continue hosting these events, which are resulting in added sales pipeline and accelerating opportunities already in the pipeline.

We also announced Blackbaud SKY in October at our user conference, bbcon. Blackbaud SKY, which started with NXT, is really the embodiment of our integrated and open cloud solution strategy. Over time, Blackbaud SKY will become the standard set of capabilities across our cloud solution portfolio and will support the ecosystem of partners, developers, and customers. Blackbaud SKY includes infrastructure, processes, and integrated services to deliver total solutions, all within a highly secure, scalable, and high-performing cloud environment. We're driving towards a single user experience across all of our solutions to help encourage learnability and adoption.

To that end, SKY UX was introduced as our new product-agnostic user interface, which is intended to create a consistent, always modern user experience. SKY UX is now the standard UI development platform across our solutions, available to our partners as an open-source development resource and has already been used in developing our latest solutions like our recently announced Blackbaud outcomes solution. The open-source SKY UX is currently in the early-adopter stage with a few partners, after a successful technical preview program. The next generation Luminate solution will be adopting SKY UX in 2016, moving us closer to SKY UX becoming the standard in our portfolio.

We also introduced SKY API, which will give Blackbaud customers, partners, and our application developers access to industry-standard [REST] open APIs and a comprehensive set of resources which allow them to customize, integrate, and extend functionality of Blackbaud solutions. We are currently in the technical preview stage for the open-source SKY API, in advance of an early-adopter program. These Blackbaud SKY open-source initiatives clearly demonstrate the new Blackbaud having not only modern cloud products, but cloud open-source development toolkits for our partners and customers. We expect this to further drive industry adoption of our solutions and standards.

Over the course of 2015, we have also spoken about the positive customer reaction and rapid adoption of enterprise CRM 4.0, the latest version of our enterprise platform. Our trend in rapid adoption continued through the fourth quarter, with roughly 90% of enterprise CRM customers now using one of the two most recent versions. Transitioning customers off of the prior versions will allow us to redeploy engineering resources to develop new innovations, which should translate into revenue and margin growth.

Now let's turn to our second strategy, which is driving sales effectiveness. We added to our five-point growth strategy at investor day to include this initiative, as we are laser focused on creating a world-class sales organization to drive healthy top-line growth. The heavy lifting really began after I joined Blackbaud two years ago, with the implementation of a single best-in-breed sales automation platform and segmentation of our sales and customer success teams. More recently, we've been equipping our teams with sales tools, streamlining processes, deploying account executives into the field, and increasing headcount in areas like sales, and customer success. We have a formal sales excellence program to drive these efforts. We also recently announced the creation of an indirect sales channel, bringing VARs into our Blackbaud partners program to begin selling a subset of our solutions in 2016.

In 2015, we were roughly 10% penetrated into our $6.3 billion total addressable market, which is expected to grow at a CAGR of over 7% annually. The giving market continues to be healthy, with higher growth and online giving growing at 9.2% year over year, according to the Blackbaud index. A great example of the shift towards donating online is Giving Tuesday, which occurred this past December 1. Giving grew 52% year over year, representing $39.6 million in online giving in a single day. And the growth in giving using a mobile device was up 30%. A great example is the University of Michigan, which raised $4.4 million in a single day, with nearly 7,000 donors. This represented a 34% increase in donations and a 27% increase in the number of donors for the University, when compared to 2014. Blackbaud is very well positioned for the conversion to online.

We are pleased with our performance in 2015. We achieved non-GAAP organic revenue growth adjusted for constant currency of 8.5% in the fourth quarter, and 7.7% for the full year. This is a 60-basis-point incremental improvement for the full year over 2014, and squarely at the midpoint of our long-term aspirational goal range of 6% to 10%. This performance is particularly strong, taking into account that we are in the first year of our mid-market cloud transition with Raiser's Edge NXT and Financial Edge NXT, which includes some drag on revenue with the shift from up-front license to ratable revenue recognition.

Now let me turn to our third strategy, the expansion of our total addressable market, or TAM. Our approach is to expand TAM through acquisitions into new and near adjacencies. Our strategy dictates that acquisitions will accelerate our shift to the cloud and be accretive from a revenue and margin perspective. We executed this strategy in 2014, with the acquisitions of WhippleHill and MicroEdge, and again in the fourth quarter of 2015 by completing the acquisition of Smart Tuition on October 2. The result of these three acquisitions added incremental TAM of over $1.5 billion, and complementary SM [Bria] cloud solutions to our portfolio.

I'm pleased to report that post-Smart Tuition, we now service roughly 35,000 customers in the global philanthropic community. With the addition of Smart Tuition, our existing solutions now help K-12 private schools manage fundraising, financials, the school operations, and tuition, which accounts for the vast majority of K-12 private school revenue. Blackbaud offers a full range of solutions for their sub-vertical.

We spent time covering the significance of the K-12 private school market this past December at our investor day. It represents a $1.2 billion TAM opportunity. This is a very large and underpenetrated market for us, and we believe delivering an integrated suite of best-in-breed solutions offers tremendous value. A real example of this is Proctor Academy, which is a private co-educational day and boarding school for grades 9 through 12 located in Andover, New Hampshire. Proctor is using our legacy Financial Edge, Raiser's Edge NXT, complete WhippleHill on suite, and added Smart Tuition solutions in the fourth quarter of 2015. That is over 10 Blackbaud solutions being used by a single customer. We have seen early cross-sell opportunity presented by the WhippleHill and Smart Tuition acquisitions, with plenty of future opportunity ahead. It is still early days in K-12, but we are seeing good traction with the adoption of the integrated suite offering and are excited about this market.

Our fourth strategy is to streamline operations. We have modified the strategic initiative, shifting focus off of the consolidation and upgrade of our back-office systems -- given these implementations are largely behind us -- and our focus has now shifted towards process optimizations. Internally, we refer to this as our Blackbaud quality initiative, which is sweeping across the entirety of the organization.

Our final strategic area of focus is the execution of a three-year margin-improvement plan. Our long-term aspirational goal calls for a non-GAAP operating margin of 20.5% to 23.5% at 2014 constant currency by the time we exit 2017. This is a 300- to 600-basis-point improvement from our baseline of 17.5%, which was the midpoint of our original 2014 guidance. On a full-year basis, our operating margin improvement now stands at 130 basis points over the prior year using 2014 constant currency and 160 basis points over our 17.5% baseline. It is important to note that these leverage gains are somewhat offset by our NXT mid-market cloud transition. We will continue driving improved operating leverage across our business over time, balanced against investments into the business to drive future top-line growth.

Overall, I am very pleased with our progress in the quarter and for the year. Our solid 2015 financial performance is a result of strong execution against our five-point growth strategy. Our improved organic revenue growth is the outcome of investments in the business, the shift to subscription-based revenues, and innovation and integration of our solutions. We continue to maintain a focus on efficiency and profitability. Our improvement in non-GAAP operating margin over the prior year reflects the results of these concentrated efforts. We made a significant strategic step forward in 2015 with the announcement of Blackbaud SKY, which expands our capabilities, widens the differentiation gap between us and the competition, and will ultimately deliver more value for our customers.

I'll now turn the call over to Tony to cover our financial performance in greater detail, provide our 2016 guidance, and give an update on our long-term aspirational goals before we open up for Q&A. Tony?

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Thanks Mike. Good morning, everyone, and thank you for joining us on today's call. We had a solid quarter and a strong finish to the year. I will direct you to yesterday's press release and the quarterly investor relations materials posted to our website for the full details of our financial performance as I will focus on key highlights today.

Our fourth-quarter non-GAAP revenue was $178.1 million, an increase of 13.1% over the prior year, or 8.5% on an organic basis adjusted for constant currency. This was our peak 2015 quarter in terms of revenue dollars and recurring revenue mix. Non-GAAP recurring revenue represented 77.8% of total revenue, which is 420 basis points higher than Q4 of 2014, and grew 11.2% on an organic basis before adjustment for constant currency. Our recurring revenue continues to be fueled by non-GAAP subscription revenue, which accounted for 56.3% of total revenue in Q4. This is an 830-basis-point improvement over Q4 of 2014, and growth of 19.7% on an organic basis before adjustment for constant currency.

Growth in subscriptions is the result of our strong and balanced performance across the cloud portfolio, the incremental addition of Smart Tuition revenue, and the first full quarter of NXT revenue from clients that have gone live on the solution. I will note that Q4 2015 marks the fourth sequential quarter of decline in our non-GAAP maintenance revenue, which was anticipated. And we expect to continue seeing this trend going forward as we migrate our installed mid-market base to subscriptions with NXT solutions. If you exclude the maintenance revenue associated with MicroEdge, which we acquired in Q4 of 2014, maintenance revenue declined for five sequential quarters as a result of our announcement of the NXT solutions.

On a full-year basis, we delivered non-GAAP revenue of $647.3 million, which exceeded the high end of our original 2015 guidance, was in line with our most current guidance, and represented double-digit growth of 13.4% over 2014. Non-GAAP organic revenue growth adjusted for constant currency was 7.7%. This is squarely within our long-term aspirational goal of 6% to 10%, on target with our 7.5% to 8% full-year expectation that we communicated on our third-quarter earnings call, and 60 basis points higher than 2014. This performance is especially strong when considering 2015 was the first cloud transition year for our two mid-market flagship solutions, which is a drag on revenue performance.

We crossed two major revenue milestones in 2015, with non-GAAP recurring revenue exceeding 75% of our total revenue and non-GAAP subscription revenue crossing the 50% mark. Our non-GAAP recurring and subscription revenue now stand at 76.4% and 52.1% of total non-GAAP revenue, respectively. And our non-GAAP organic revenue growth before constant currency adjustment was 9.2% for recurring revenue and 15.6% for subscriptions revenue. This compares to total non-GAAP organic revenue growth before constant currency adjustment of 6.1%, which means that recurring revenue is growing 50% faster than total revenue, and a positive driver of total Company growth. This bodes well for the future given we continue to transition the business to one driven by recurring subscription revenue.

For the quarter, our non-GAAP gross margin was 56.7%, which is a 20-basis-point improvement over Q4 of 2014 before adjustment for constant currency. The fourth quarter is seasonally the lowest gross margin quarter of the year, given the dilutive effect of our payments business which experiences its seasonal high point in Q4. For the full year, our non-GAAP gross margin was 58.3%, which is a 130-basis-point improvement over 2014 before adjustment for constant currency.

Moving down the income statement, in the fourth quarter, we generated non-GAAP operating income of $32.2 million, representing a non-GAAP operating margin of 18.1% and non-GAAP diluted earnings per share of $0.38. Our non-GAAP diluted earnings per share would have been $0.39 if it had not been for a reevaluation of foreign currency negatively impacting other expense by approximately $500,000. For the full year, we generated non-GAAP operating income of $122 million, which is nearly a 20% increase over 2014. This results in non-GAAP operating margin of 18.8%, or 19.1% adjusted for constant currency, which is a 130-basis-point improvement over 2014.

Both non-GAAP operating income and margin exceeded the top end of our original 2015 guidance ranges and were within expectation of our most recently issued guidance. Achieving a 19.1% margin adjusted for constant currency keeps us well on track to deliver on our long-term aspirational goal of 20.5% to 23.5% by the time we exit 2017. Non-GAAP diluted earnings per share of $1.50 also exceeded the high end of our original 2015 guidance, was within expectation of our most recent financial guidance, and is a $0.23, or 18.1%, improvement over 2014.

I will point out that we fixed our non-GAAP tax rate at 39% for 2015, which is well above our 2015 GAAP effective tax rate of 30.6%. Thus, we did not receive the full tax benefit in non-GAAP net income and non-GAAP diluted earnings per share. We will be lowering our fixed non-GAAP tax rate in 2016 to better align with our estimated GAAP tax rate, which I will cover in a moment.

Our cash flow from operations for 2015 was $114.3 million, growing 12% over 2014 and slightly below the $115 million low end of our guidance range. The modest shortfall was caused by variances in our acquisition and integration cost estimates and separation-related expenses. Overall, we posted strong double-digit growth across all categories in 2015, inclusive of foreign currency headwinds and our mid-market cloud transition.

On the capital structure side of the business, the Smart Tuition acquisition was completed on October 2 and was financed with cash on hand and borrowings under our existing credit facility for a net cash outlay of $187.8 million. At the end of the fourth quarter, our debt-to-EBITDA ratio using our bank calculations was less than 3 times, and we are now in the process of delevering by paying down our debt.

In summary, we executed well against our strategic plan in 2015. We ramped performance as a result of our investments aimed towards sales, retention, innovation, and quality, as well as the expansion of our addressable market. We continued to execute on our capital deployment strategy to maintain a strong balance sheet, return capital to shareholders, and create growth and scalability.

Now let's turn to 2016, starting with our financial guidance. We are guiding to non-GAAP revenue of $725 million to $740 million; non-GAAP operating income of $141 million to $147 million; non-GAAP operating margin of 19.4% to 19.9%; non-GAAP diluted earnings per share of $1.90 to $1.98; and cash flow from operations of $145 million to $155 million.

Our 2016 guidance builds upon our solid performance in 2015, and once again represents strong double-digit growth across each category, inclusive of foreign currency headwinds and in the first full year of our mid-market cloud transition to NXT. The midpoint of our guidance implies over 9% organic revenue growth adjusted for constant currency, which is at the high end of our 6% to 10% annual aspirational goal and a nice improvement over the 7.7% growth in 2015.

We are maintaining our organic revenue long-term aspirational goal of 6% to 10%, normalized for 2014 constant currency, and are very pleased that guidance at the midpoint implies we will be towards the top end of this range. Our 2016 operating margin at the midpoint and adjusted for constant currency is above 20%, near the low end of our 20.5% to 23.5% long-term aspirational goal and improves upon the 19.1% posted in 2015. We are maintaining our non-GAAP operating margin goal of 20.5 % to 23.5% adjusted for constant currency, or 300 to 600 basis points of improvement by the end of 2017.

We are excited to update and increase our aggregate cash flow aspirational goal to be between $500 million to $550 million for 2014 through 2017. This is a $100 million increase from our previous goal, which is reflective of our strong financial performance and the impact of our accretive acquisitions completed after we set these goals in 2014.

I would like to turn to some assumptions that we used in developing our 2016 guidance. We used the closing rates on February 1, 2016, as our measurement date for modeling the impact of exchange rates within our 2016 financial guidance. Based on these assumptions, we estimate the currency impact to decrease revenue by $5 million to $6 million on the year, which equates to a negative drag of approximately 80 basis points on our non-GAAP organic revenue growth. Our estimated impact to non-GAAP operating income is approximately $2 million to $3 million, resulting in a non-GAAP operating margin drag of roughly 20 basis points for the year.

We communicated at investor day the adjustment of our non-GAAP tax rate from 39% to 36% beginning in 2016. Historically arrived at 39% using a federal rate of 35% and an average state rate of 4%. We reduced this estimate 3 percentage points based upon a domestic production activity deduction and the state R&D tax credits that are recurring allowable tax deductions. We are now further reducing our estimate by an additional 4 percentage points as a result of the permanent extension of the R&D tax credit by Congress which occurred subsequent to our investor day. This results in a non-GAAP tax rate of 32% for 2016.

In 2015, our non-GAAP fixed rate of 39% did not reflect the benefits of our improved GAAP tax rate. Had we applied our updated non-GAAP tax rate of 32% to the fourth quarter and full year of 2015, it would have resulted in non-GAAP diluted earnings per share increasing by $0.05 and $0.17 per share, respectively.

Next, our estimate for 2016 capital expenditures is $45 million to $50 million, which includes costs required to be capitalized for software development. We are estimating $20 million to $25 million of capitalized software spend on innovation, with the balance of capital expenditures related to incremental and infrastructure investments to support our continued shift to the cloud.

I also want to ensure everyone understands that our long-term aspirational goals, which we initially introduced at our 2014 investor day, are in place through 2017, are calculated on a constant currency basis using 2014 as the base year. We believe this allows us to better track our business performance improvement by excluding the noise of currency-rate fluctuations.

As a reminder, our method of calculating organic revenue growth for 2016 will pro forma Smart Tuition as if we had owned them for the full prior year. For a more detailed discussion of our method to calculate organic revenue growth, please refer to the organic revenue growth presentation found on the Investor Relations section of our website.

In summary, 2015 was a great year. We are pleased with the progress we made across the board, and plan to continue carrying that momentum into 2016, which you can clearly see from our financial guidance and revision of long-term aspirational goals.

With that, I'd like to open up the line to your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

We'll take our first question.

Tom Roderick - *Stifel Nicolaus - Analyst*

Good morning. It is Tom Roderick from Stifel.

Mike, I wanted to ask the first question to you. I think at the user conference and probably at the Analyst Day as well, you did provide an update at the time with the number of NXT customers that had upgraded. Or the number of customers on RE that had upgraded to NXT -- I think that number was 1,500; let's say, around 1,000 that have implemented. Curious if you can offer some update, either qualitative or quantitative, as to how that progressed in the fourth quarter? And maybe even more interesting beyond that, what anecdotal evidence can you offer to us about pricing power and -- pricing power in the upsell, cross-sell traction you saw for early adopters on NXT?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Sure, Tom, thanks for the question.

So we continue to drive that platform. It's early days on that mid-market transition. In fact, we continue to add headcount in sales and customer success in the Company that covers a lot of products, but this product is a increasing opportunity for us. We just went live last July, as you recall. So it is fairly new. It still represents some revenue headwinds for us for a while, but it gains momentum. The customer testimonials are actually fantastic. We have a lot of referenceable clients that are creating a lot of buzz in the market. We continue to have those roadshows that we did all last year. We will continue to do them this year as well around the country. So it is a program that continues to build momentum -- all new technology; it's quite exciting. And we also have some customer testimonials, a lot of them around value prop and the impact to their business. So we are really excited about that program and it continues to do very, very well for us. It has been a great launch, and continues to build momentum.

Tom Roderick - *Stifel Nicolaus - Analyst*

Great. Tony, question for you on the margin front. I guess it's now a two-part question, because the lower tax rate buys you probably, by my math, about $0.10 of earnings power relative to what we were previously modeling. As that flows down to your cash flow line, how much is the lower tax rate? Is it impactful on the cash flows? And how should we think about the tax rate impacting the raise you put into the four-year aggregate of the cash flow number by $50 million?

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Thanks, Tom.

I think how I would think about the impact on free cash flow and cash taxes and our recent change, because we had, as you know, a twofold change. At Investor Day we had discussed reducing our non-GAAP effective tax rate. We typically have pegged our rate at from 39% down to 36%, and that was to try and more closely match our non-GAAP rate with our GAAP rate, which I would like to talk to a little bit more because it had a fairly large impact in the quarter. That's still being pegged at that 39%, and caused us to miss our EPS.

But as I think about the impact on cash taxes and cash flows, the subsequent change that we have made now have gone from 36% to 32%. That entire 400 basis points was driven by Congress passing the permanent extension of the R&D credit at a federal level subsequent to our investor day. So that was one that was one of the Bush tax credits that had come and gone with some of that extensions that they've done over the years. And it caused quite a bit of volatility in our rates. And, as a matter of fact, because it was not extended until Q4, it drove a very high volatility in our GAAP rate for the quarter and for the year. And so we adjusted down to that 32%, and we've built that entirety of that 400 basis points into our estimates. And so I would suggest, from a modeling perspective, you would want to take into consideration that same 400 basis-point improvement from a cash flow perspective as well. And then I have to leave it to you and your models as to what you are projecting for overall taxable income and the other components.

I think on the side of the quarter, I want to make sure folks are clear on how we were impacted. There is a couple different methods you can use from a non-GAAP tax rate perspective, and we have historically pegged our rate, as you are aware, at 39%, and now is going to go down to 32%. The difficulty we had in the year -- and we had this in prior years as well and especially in the quarter -- is, when our actual GAAP effective rate is below 39%, the positive benefit of those GAAP tax adjustments do not flow through to non-GAAP basis because of the way we pegged the rate. And so in the quarter, had we taxed-affected our tax adjustments, we would have on -- using a 39% rate not a lower rate -- we would have had $0.04 per share higher EPS. On the year, it would have been $0.06.

And it is just a mathematical equation, which I'm happy to talk with you more about. But by going to a 32% rate where we think we're going to run in a -- historical, we've been running at about a 28% to 32% GAAP rate -- we should match much more closely, and therefore, have much less impact on that item going forward.

Tom Roderick - *Stifel Nicolaus - Analyst*

Got it. The last quick one for me.

Mike, I am interested to hear your thoughts on the broader thoughts on the macro. Obviously, there is a lot of choppiness out there, some companies are starting to show it and some haven't shown it yet. What are your thoughts on what are you seeing from your customer base? What you're hearing them about their budget going into this year? And how does that encourage you to think about the pace at which you want to put additional investment into the operating lines of the business?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Good question.

What is interesting for us is, because the customer base and our entire market are nonprofits and foundations, they don't necessarily likely mirror the for-profit world. Just going back in history, the sector, pretty much from a giving standpoint, has tracked with the US GDP for 40-some-odd years. That is one point. It is a very large market, and it is pretty healthy and growing. And it is in its early days of switching to online. The online percentage in the US is less than 10%, and a lot of our opportunity is to drive that transition which is needed in the industry. And our share of the market is pretty small.

So it is a pretty resilient marketplace. If you go back to 2008 and 2009 and you look at Blackbaud results, our non-GAAP revenue grew and we posted some pretty strong earnings in the 2008/2009 timeframe. So I am not all that worried about that. It is early days for this industry to move to online and mobile. We are quite well-positioned for that. We are not heavily penetrated in the space because it is such a large space, so I don't see that as a concern for us to continue to drive the business forward. And frankly, feel pretty good about last year's results, and the guidance that we just gave for this year.

Tom Roderick - *Stifel Nicolaus - Analyst*

That's a lot Mike. Appreciate it.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Tom, just one thing I want to make sure I clarify on the cash taxes, as I was just thinking through that. I want to make sure you understand, we expect -- despite the change in rate and the extension or permanent extension of this R&D credit -- we do expect our cash tax outlay to go up year over year. So my cash flow guidance would actually expect an increase in cash taxes, just because we're moving into a full cash tax payer.

Tom Roderick - *Stifel Nicolaus - Analyst*

Got you. So your cumulative increased on the cash flows has far more to do with operational than any optical benefits of the lower tax rate.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Yes, and when you look at 2016 guidance and the longer term, it is really that significant improvement year over year as the organic growth and margin improvement in the business, contribution for the Smart which is very seasonal. We bought Smart in the fourth quarter; a lot of their cash flow comes in around that initial school year ramp midyear, so we got a three-quarter improvement in cash flow from Smart. We expect some continued improvement in working capital this year and next year. And right now we're not anticipating deal costs or other severance costs, which was a bit of a positive impact year over year. And then that would be offset by an increase in cash taxes.

Tom Roderick - *Stifel Nicolaus - Analyst*

Great. Thank you, guys. Appreciate the help.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Thanks, Tom.

Operator

And we'll take our next question.

Steve Ashley - *Robert W. Baird & Co. - Analyst*

Hello, it's Steve Ashley from Robert Baird.

I would just like to start by asking about the payments business. Maybe you could bring us up to date on what kind of traction you are receiving with payments from new customers attaching? And then, if you are seeing engagement in anything around transaction processing metrics you could give us?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Hello, Steve. It is Mike. I'll take that.

So again, to my earlier comment around it's early days for the industry to move online. It is also the same related to our ability to keep just driving the payments transaction and customer acquisition pace forward. And we see a nice uptick every month, every quarter, in net new clients and existing clients moving to our payments platform. The big value prop for us is the deep integration with our core solutions. And so with that integration, it better operationalizes the payments flow for our customers, which eliminates internal back-office operations for them. And so there is a pretty straightforward value prop.

We are not heavily penetrated in the market. We are not heavily penetrated in our existing client base. And so, the combination of our focus on cross-selling into the base and just including that capability with net new clients, or with clients that are moving, let's say, from Raiser's Edge to Raiser's Edge NXT -- it's a core part of the offering, which has not always been the case, continues to drive the momentum there for us. And we are barely penetrated in the market. So I see a long-term runway here for helping our clients better automate this and driving our growth on that product line.

Steve Ashley - *Robert W. Baird & Co. - Analyst*

And just the revenue -- we would all love to get any comment around what kind of contribution. Is it moving the needle at all today?

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Steve, this is Tony.

I think -- we don't provide that granularity. But what I'd tell you is, we have seen -- at least this last year, we saw -- fairly consistent growth in our recurring subscription line as what we saw in payments. And I think as you look at some of the cues and MD&A you'll see that theme. But what I can tell you is, payments not necessarily wildly outgrowing the recurring subscription business from that perspective. So a good mix on both sides.

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Just add to that, Steve, too -- which means we have a pretty healthy organic growth across our product portfolio, of which payments is one. So it is fairly spread out nicely for us.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Which is important to note, because obviously it has a dilutive impact on gross margins just with the nature of the accounting treatment being on a gross basis. If payments was growing faster, we would see a dilutive effect in our margins.

Steve Ashley - *Robert W. Baird & Co. - Analyst*

Got it. Perfect.

And then I would just like to ask about RE NXT and new customers. Is RE NXT provide any advantage or ability in terms of recurring new customers, vis a vis what the hosted version might have been? Or any change there?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Just from a product standpoint, it is just so significantly different. We have clients, either new or existing, that moved, that have shared a lot of stories about how the impact of that NXT product has on their productivity. And we have client stories around handing volunteers an iPad, and they are instantly able to use the platform because it is intuitive.

And also because it integrates analytics and online and payments, the value prop is so much wider than anything we have had historically or anything, really, that they've seen in the marketplace. So it has integrated what were historically multiple standalone value prop products into a more comprehensive solution that just covers a whole host of challenges that get solved with this new platform. So yes, a big uptick in ease of use and ROI and value prop coverage for new and existing customers.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

And I think the total cost of ownership and the barrier to purchase is lower as well, because it's a subscription model. So I think that is helpful as well from a budgetary and resource perspective to implement and use.

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

A specific example is, clients get, when they log in, they get dashboards that show up, topical driven multi-color dashboards that show up with data that is in front of them that is actionable, where historically, they would have to run a report overnight. It's just widely different than the previous version of the platform, and also what they have seen from a competitive standpoint, built by job type or roles as well.

Steve Ashley - *Robert W. Baird & Co. - Analyst*

Thanks so much.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

You bet.

Operator

And we'll take our next question.

Brad Sills - *BofA Merrill Lynch - Analyst*

Hello, guys, Brad Sills here.

I wonder if you could provide a little color around Financial Edge NXT. It's been a recent launch. Can you just describe how the reaction has been to the offering? Are you starting to see some good traction on the migration there?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Yes, sort of like RE NXT, but launched a little bit later. It's picking up steam. The value prop is a little different than RE NXT, but the modernization of the solution is the same. What I mean by that is, RE NXT, as I just mentioned, incorporated multiple products, so it really broadened its value prop. Where FE NXT, modern UI, modern workflow, but did not incorporate five or six other products like RE NXT did. But the uptick is happening there. The cross-sell opportunity exists, just like it does with RE NXT.

Brad Sills - *BofA Merrill Lynch - Analyst*

Got it. Great, thanks.

And could you remind me what install basis is left that's on legacy RE? And what is your expectation for migration there?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Yes. I'll just remind you that, back earlier I had an another question on this when we talked about before, when we were disclosing the NXT numbers. We had disclosed 1,500 sold back then, the last time we disclosed, and there's about 13,000 RE customers that we have. So it's early days. The product went live in July. The momentum builds. It is going to take a while for us to convert customers, but we are converting customers at a pretty healthy clip and we are signing on brand-new-to-Blackbaud names as well.

Brad Sills - *BofA Merrill Lynch - Analyst*

Great, thanks. And then the gross margin for subscription declined. I assume a lot of that is just seasonality with payments, but is there anything else going on with subscription margin?

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

I think on a GAAP basis, Brad, the other two things that would be impacting subscription gross margin and will be an impact going forward is, our acquisitions have largely been -- at least, the recent acquisitions with WhippleHill, MicroEdge, Smart -- have largely been subscription-related; Convio would have been as well. So any amortization of finite live intangibles related to the acquired software would end up in the subscription line. And so you have that, which is a fairly significant impact on a GAAP basis.

And then, secondarily, we, in the execution of our five-point growth strategy, were spending -- investing more in R&D. And as a result, as we've guided to, you're seeing a higher capitalized R&D amount, and that is largely associated with these new cloud products. And that includes Raiser's Edge NXT, Financial Edge NXT, the new Outcomes product, the investments in AngelPoints, the new Luminate NexGen, the Everyday Hero US, Outcomes -- I'm trying to remember if I've mentioned them all. But a lot of incremental investment in innovation resulting cap software, and then that amortization would largely all end up in the subscription line as well up in COGS. And hence, you see a lower R&D down below the gross margin line. But we are actually spending more in R&D in total; it is just that it is getting capped and then amortized through that line. And then the rest would be mix.

Brad Sills - *BofA Merrill Lynch - Analyst*

Got it. Great. Thanks, guys.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

You bet.

Operator

And we'll take our next question.

Kevin Liu - *B. Riley & Co. - Analyst*

Hello, good morning. It's Kevin Liu with B. Riley.

First, on the capitalized software expenses, so with RE and FE NXT, I would have thought that maybe it would start to stabilize, just not come down. Could you just talk about where the incremental investment for this year goes? Is it tied to Smart Tuition or some the other core products? And when would you expect that number to start to peak?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

I will take the first part of that. Hey, Kevin, it is Mike.

So from a software standpoint, and I'll just build on what Tony said. We have a much higher focus on innovation than we've had, I think, historically as a Company. You saw that with NXT -- RE and FE NXT -- but that continues to hit a lot of our products, like Luminate. We announced at our client conference that we will be coming out with what we're calling Luminate NexGen this year, which will incorporate and use some of the SKY capabilities, like SKY UX for example. We had a big announcement at bbcon around capability in RE NXT called non-profit intelligence, which is a business intelligence and reporting capability. That non-profit intelligence capability will be coming out in Luminate NexGen as well, which we announced at bbcon. And also things like the drive on enterprise CRM 4.0. And in my prepared remarks, the conversions to 4.0 that we saw last year, almost all of our clients now are on 4.0 or the most previous version.

So we have a pretty big shift toward innovation, and a shift toward the spend, if you will, and FTE hours in engineering from things like maintenance and legacy platforms to new solutions and innovations that is happened. Which is where we want to be, and really healthy for the Company and for our customers. So it is pretty spread out. NXT Luminate, payments, some of the product lines around gifts online and AngelPoints, the WhippleHill on products. A lot of innovation, a lot of integration happening across the Company that's fueling the organic growth and the client acquisition that we are seeing.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Kevin, I would highlight a couple other things that impacted as well. The accounting treatment for internal use software, the window that the guidance dictates that you capitalize, the costs incurred during that development window is wider on a SaaS in the cloud-type product than it would be for a license model. So, to what Mike said, with the increased innovation, our other components of strategy we talked about two years ago at Investor Day of optimizing our product set. So we are spending more in total R&D dollars; we are reducing our product portfolio and optimizing it; and then have also made a big focus in the last two years on improving quality. So we have a lot fewer bugs to spend time and money on, so by definition, we are spending a lot more dollars per product on innovation. And then the window -- just because of how the GAAP guidance works -- the window is wider in these cloud-based solutions that are going to be rented under a subscription for what needs to be capitalized and amortized. So all of those combined together results in this higher dollar cap software.

Kevin Liu - *B. Riley & Co. - Analyst*

Got it. And then maybe just a higher-level question.

Obviously, guys are guiding this pretty strong organic growth for this year, so it seems like you don't feel it impacted at all by the macro. But as you look at your sales cycles today, and maybe the flows coming through your payments business, any concern at all just regarding how the macro might impact you and your customers? And then even beyond that, I am just curious as to whether the shift on the mid-market side is giving you maybe more incremental visibility into your growth for this current year?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

I'll take that, Kevin.

So, no, we don't have the same concerns that other software companies might have on the macro, given that, again, we are focused on solely nonprofits and foundations, which behave a little bit differently. And given the fact that our reoccurring revenue is becoming a pretty large percentage of our total, and the subscription organic growth in total is quite healthy for us. So customer acquisition is going quite well; again, we are adding to sales headcount. We are adding to customer success headcount. And we just have a big focus on innovation and making our customers successful. So I'll point back to my earlier comments around the 2008/2009 timeframe: the Company performed well. So we think we're going to have a solid year to the guidance that we performed, and subscription growth continues to climb. So we feel pretty good about the environment and our ability to execute.

Kevin Liu - *B. Riley & Co. - Analyst*

Great. Thank you for taking the questions.

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

You're welcome.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Thanks, Kevin.

Operator

And we'll take our next question.

Unidentified Participant - *- Analyst*

Hello, this is Anabav sitting in for John.

So maybe just a quick one on the macro and a couple after that. So on the macro -- is there any lead indicator maybe you are giving as a proxy or something else that we could use to say we're actually seeing it? Or going forward, would probably use (technical difficulty)?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Yes. Well it is not a straightforward single metric. So our Company revenue is not all driven by giving. So giving last year in 2014 was $358 billion in the US. And the growth on the online side in 2015 was nearly six times the total growth and online is less than 10%. So our revenue drivers -- a small part of it, if you will -- is driven by actual giving, which would be our payments line. But our other revenue drivers are around things like usage of systems, and the move to online continues and will continue -- in fact, will accelerate. We have seen acceleration in things like mobile giving, which was nearly 14% last year. So it continues to grow. And so it is not a single metric. And the last thing I will say is our percentage of TAM in the space is not very high. So the industry has remained healthy through lots of turns in the marketplace over the last 40 or 50 years, and our percentage of total is fairly small. And it is going through an early transition to online, so we think we are positioned quite well.

The last thing I will say, too, is, historically, the -- when there is some difficulty in the stock market, it might impact major gifts, which is not the largest percentage of total. So of that $358 billion number, a little over 70% were gifts by individuals at a very small amount, which the market doesn't necessarily impact per se. So we are positioned quite well in the space and we don't see a macro headwind to our guidance that we gave this morning.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

And I think the only thing I would add to it is, the strategic acquisitions we have done over the last few years have helped us to diversify our source of revenue as well. So keep in mind, a lot of times people want to focus on giving -- to Mike's point -- and we've talked through all the pieces of our market penetration and the total TAM and the size of it. Also, we'd want to focus on that, with WhippleHill for instance and Smart, we've diversified significantly into the private K-12 school space. And tuition, and the tuition does not have anything to do with giving. So kids are still going to go to school, at private schools, and parents are still going to pay that tuition. So we have the diversified into that revenue stream.

If you think about large hospitals -- their revenue streams are driven by things other than giving as well in many cases. So you have to look across the broad spectrum. And I think that our acquisitions we have done over the last few years and some of the product innovation work has helped to diversify the revenue streams as well. And it is not, to Mike's point, not all tied back to giving and fundraising. Foundations -- we now also sell solutions to for-profit corporations through our corporate responsibility solutions, outcomes between foundations and grant recipients, AngelPoints, those kind of solutions. So we have diversified well.

Unidentified Participant - - *Analyst*

Great. That was very helpful.

Now just moving on to the SKY API, the new platform that you have. As of now, I think it might be a little too early, but are you seeing any new partners or when do you expect to see an impact from that as far as it goes?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Sure, so the SKY platform -- both REST API and UX -- we have used pretty extensively internally starting with the NXT line and moving across other products like Outcomes and soon to be Luminate. Just in the last quarter did we open it up to partners, and it's going through early adopter partners and then an early adopter to a release phase, UX first, API second. And they're both in process right now. So we'll start to see partners pick up on using SKY UX and SKY API this year, but it is fairly new. So we have gone through with a handful of early adopters in the fourth quarter, if you will.

Unidentified Participant - - *Analyst*

Okay, great. And maybe one last one just under deferred revenue. I was wondering if you could just explain to us maybe what are the puts and takes that drive this line, given that you have subscription growing and maybe some of the maintenance coming off?

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

It's a tough one because we don't currently and don't have a plan to disclose enough granularity, I think, to allow you guys to triangulate back to the impact deferreds would have on future revenues. And some of the difficulties there that you'd have to keep in mind in trying to do so is, we have historically had a fairly significant amount of seasonality in our business that would affect our deferreds. So timing of renewals, for instance. And that seasonality has actually changed quite a bit with some of our recent acquisitions, with MicroEdge and certainly with WhippleHill and now Smart Tuition that is more weighted towards billing cycles midyear. And so we have that seasonality impact which we don't provide granularity on.

Also need to keep in mind that a large portion of our business is driven by transactional business; so the payments, the usage side of things. With Smart, there is also transactional and usage-related that does not get recorded as deferred revenue balance on the balance sheet. Those are recorded when earned directly to the P&L. So you have got that impact. And then I think one of the other issues that we would have wrestled with recently is just the sheer number of acquisitions that we have done, and the GAAP-required deferred revenue writeoffs on the opening balance sheets. So when you bring those acquisitions on board, you are not seeing the deferred in the balance sheet that you would expect, because you would take a fairly significant haircut in most cases on those opening balance sheets.

So we'd have to provide a great deal of granularity that we're just not open to doing today to allow you to be able to effectively understand the driver in that. So I'd just suggest instead -- and part of why we've provided the long-term aspirational goals that we have -- and then also I would refer you to our 2016 guidance and what we expect for overall acceleration and growth, which is a three-year continuing trend; and then also in the overall continued expansion in our margins. It's probably a better means for you to focus attention on.

Unidentified Participant - - *Analyst*

Great. Thanks. That was helpful.

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

You bet.

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Thank you.

Operator

And we'll take our next question.

Unidentified Participant - - *Analyst*

Good morning, thank you for taking my question here.

Michael, I realize it is still early days for the Financial Edge NXT product, but how did bookings fare in the quarter? And did the product contribute to revenue during Q4?

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

We feel good about that. We don't break out unit bookings, but it is a little earlier on FE than RE because it came out a couple of months later in Q3. But again, it is a similar story. It is RE NXT where's it building both for net new and for existing customer migrations. It is a pretty high value prop with a modern platform that the existing client base hasn't seen in a long time. So we are excited about that product, and we are excited about it being sold along with other products, like with WhippleHill [en suite] and K-12, and RE NXT and K-12, as an example.

Unidentified Participant - - *Analyst*

Okay, thank you. And then, Tony, I believe last quarter there were some services around your enterprise to your end product that just slipped a quarter or two. And I was wondering if that services work has started yet?

Tony Boor - *Blackbaud, Inc. - EVP & CFO*

Mark, we don't take out the specifics on those. I think the enterprise side of things we continue to have a little bit of softness in the quarter. Overall from services I think the new COO that we brought on board in the enterprise space, Walter, has been doing a great job. And we have really cleaned up our tracking of our backlog and pipeline on that side of the business. And I think you can -- early days yet -- we can see some of the significant improvement in the services margin in the P&L. Year over year there was a fairly dramatic improvement in those margins, and that was one of our key focus areas to help with our overall margin improvement aspirational goals. So we are happy with what we are seeing there.

The other side of the services -- we expect it to continue to be a drag on our growth rates. We expect services as a percentage of total revenue to continue to shrink as we move more and more to the cloud, and as our products mature. So as that CRM product in the enterprise space matures and we continue to innovate there, we believe the customers and clients will need to do less customization. And the implementation cycle will get shorter and require less overall services, and that is a key focus. We would like to see that services line continue to shrink as a percentage of total and the margins improve at the same time.

Unidentified Participant - - *Analyst*

Great. Thank you.

Operator

It appears there are no further questions at this time. I would like to turn the conference back to our speakers for any additional or closing remarks.

Mike Gianoni - *Blackbaud, Inc. - President & CEO*

Thanks, Operator.

Everyone, I'd like to close the call by saying 2015 was a great year, and we did an excellent job positioning ourselves to accelerate performance in 2016. We look forward to delivering on our financial guidance and reporting progress on our longer-term aspirational goals. Thanks, everyone, for your participation this morning.

Operator

This does conclude today's conference. We thank you for your participation.
