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PRESENTATION

Operator

Good day, and welcome to Blackbaud's Q1 2021 Earnings Call. Today's conference is being recorded. I'll now turn the conference over to Steve Hufford. Please go ahead, sir.

Steve Hufford - *Blackbaud, Inc. - Director of IR*

Good morning, everyone. Thanks for joining us on Blackbaud's First Quarter 2021 Earnings Call. 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 line for your questions.

Please note that our comments today contain forward-looking statements subject to risks and uncertainties that could cause actual results to differ materially from those projected. Please refer to our most recent Form 10-K and other SEC filings for more information on those risks. We believe that a combination of both GAAP and non-GAAP measures are more representative of how we internally measure our business. Unless otherwise specified, we will refer only to non-GAAP financial measures on this call.

Please note that non-GAAP financial measures should not be considered in isolation from or as a substitution for GAAP measures. A reconciliation of GAAP and non-GAAP results is available in the press release we issued last night, and a more detailed supplemental schedule is available in our presentation on our Investor Relations website.

Before I turn the call over to Mike, if you didn't get a chance to attend our virtual investor session in March, please note that a recording of the event and the full presentation are available on our Investor Relations website. I'll also mention that during the second quarter, our team will be virtually attending the Needham 16th Annual Technology Conference, Baird's 2021 Global Consumer Technology & Services Conference and the Stifel Cross-Sector Insight Conference. We will also be participating in virtual investor meetings during the quarter hosted by The Benchmark Company and BTIG.

With that, I'll turn the call over to you, Mike.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Thanks, Steve. Good morning, everyone, and thank you for joining our call today. Following a strong finish to 2020, we posted solid financial results for the first quarter, and our optimism continues to build around the coming quarters and years. The progress being made to distribute COVID vaccines is encouraging for our market, our customers and our company.

Our first quarter performance, combined with the improving macro environment, had us well positioned for a strong and successful year ahead. In fact, our latest financial outlook suggests the upside scenarios we laid out in our Q4 earnings call are looking more likely, which Tony will cover in more detail shortly.

Before I share a few highlights from the quarter, I would like to thank those of you who are were to attend our virtual investor session in March. I know I speak for the entire executive team when I say we appreciated the engagement and dialogue with the investment community. If you haven't had a chance to watch it, there were 4 clear takeaways from the event. First, Blackbaud is a leader in a large, resilient and growing global market. Our current adjustable market is over $10 billion, and that TAM has more than doubled in my 7-year tenure at Blackbaud through acquisitions, internal product builds and steady market growth. Over the same time frame, our ability to drive organic growth and make strategic acquisitions has resulted in us nearly doubling our total revenue. There's no question we have plenty of room to grow and expand both organically and with future acquisitions.

Which brings me to the second takeaway. We have multiple levers with which to accelerate revenue growth. This includes several programs already underway as well as macro-level drivers tied to the pandemic, which will abate and return quickly once the world returns to normalcy. We have a higher degree of confidence in increasing visibility into our growth reacceleration.

The third takeaway is our revenue growth and scalability will drive margin expansion, and not only do we gain scale through growth, but we're driving several strategic initiatives focused on delivering margin expansion over the next several years. And fourth, we are rapidly innovating for our customers and are well positioned as a market leader to capture the accelerated digital shift within our industry. Blackbaud is truly a one-of-a-kind company with a unique opportunity ahead.

Turning to the first quarter, I'll provide a few updates in the context of our 4-point growth strategy. As a reminder, while our strategy is unchanged, we recently modified the 4 points to elevate a specific strategy focused on employees, culture and ESG initiatives. This isn't new for us. It's something that's been in our DNA for a long time, and it's a big advantage as we look to attract and retain top talent. You'll find this evident in our 2020 Social Responsibility Report, which was released last week, and demonstrates how our company responded to the unique challenges the pandemic created for our employees, customers and communities.

We also expanded this year's report to include voluntary ESG reporting disclosures that align with the Sustainability Accounting Standards Board and Global Reporting Initiative. To highlight one of the many reasons I'm incredibly proud of this report, I'll note our company is comprised of 46% female employees and 54% male employees, which positions us as a leader in our industry. We are fully committed to continuing to create a diverse and inclusive environment at all levels of the organization.

Recently, our Chief Marketing Officer, Catherine LaCour, was named one of the Top 50 Most Powerful Women in Technology by DiversityFirst and the National Diversity Council. This is a tremendous award honoring female leaders who have become champions for diversity in the technology industry as well as inspirations in their communities. Also, with many of our employees living near our headquarters in Charleston, we're proud to have been awarded the Diversity Champion award by the Charleston Metro Chamber of Commerce, which honors a company who is committed to creating a more diverse, equitable and inclusive workplace and community.

That brings me to another recently revised point in our strategy, which is to lead with world-class teams and operations. This expands upon our previous strategies to drive sales effectiveness and improve operating efficiency to include improving overall company performance, as measured by the Rule of 40. We have a strong executive team who are all incredible leaders, delivering on our mission and executing on our strategy. And we have tremendous talent across the company at every level aligned with these goals as well.

Our people are just one reason I'm excited about the opportunity in front of us as we continue to drive the business forward, which is a good segue to our next strategy to delight customers with innovative cloud solutions. As we've said, 2020 required unprecedented speed and scale to support our customers, and we were quick to reprioritize expedite product enhancements to support our customers' changing needs as they scrambled to operate digitally. We've carried that momentum into 2021.

For example, we upgraded virtually all of our Blackbaud Grantmaking customers to a new SKY UX version in just 1 month's time. This is a big deal for our customers, and it enables them to alleviate their IT burden, improves data security with multifactor authentication and provides freedom and flexibility to access advanced grantmaking technology anywhere via any browser on any device. With more veteran grantmakers using mobile technology and a younger generation of grantmakers emerging in the philanthropic community, providing convenient access to grants data and grants management tools will continue to be critical for success.

Blackbaud plays a crucial role in accelerating our market's move to the cloud. In higher education, for example, with the COVID-19 pandemic, accelerating the need for powerful cloud-based systems that allow for easy collaboration, Blackbaud CRM has been the trusted solution for a growing number of institutions to support their overall advancement needs. Institutions, including Baylor University, Clemson University, University of Houston, University of Louisville, University of Saskatchewan, University of South Carolina and West Virginia University Foundation have recently gone live on or selected Blackbaud CRM in Microsoft Azure.

In fact, a recent third-party study found that institutions using Blackbaud CRM were able to raise more money at a faster rate, with a 63 percentage point increase in funds raised compared to non-Blackbaud CRM institutions. I could go on, but these are just a couple of examples of how we're delighting customers through our innovative cloud solutions.

With that, I'll turn to our strategy to expand our total addressable market by acquiring, building and partnering into near-adjacent markets and expanding within our existing markets. This strategy is unchanged and has been a very successful strategy that we've been executing for years. With a combination of organic growth and M&A, we have a proven history of double-digit revenue growth. We continue to evaluate opportunities for M&A, and through our innovation on the SKY platform, we've created additional optionality to build and partner as well. I'm particularly excited about the momentum we're seeing with Blackbaud Marketplace, where we've seen an over 150% increase in apps available in the Marketplace. In fact, 1 out of 4 Blackbaud customers have extended their solutions with a SKY application.

I'll summarize by saying I continue to be bullish about the opportunity ahead of us. Our market has shown its resiliency. And as the vaccine rollout continues, organizations are planning for post-pandemic recovery, which is expected to include more budget dollars for software investments. As part of our planning, we recently conducted a market study with the help of a third-party firm, and they found that even during the pandemic, organizations were anticipating an increase in their annual software spend over the next few years.

Blackbaud is well positioned to capture this growth opportunity. We're accelerating investments in key areas like digital marketing, engineering, security and customer success as we look to extend our leadership position. And we have our sight set on a substantial opportunity ahead of us to drive meaningful acceleration in financial performance in the context of the Rule of 40. Overall, we had a solid start to the year, and I'm increasingly optimistic about what's to come in 2021 and over the next several years.

With that, I'll turn the call over to Tony before we open it up for Q&A. Tony?

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

Thanks, Mike, and good morning, everyone. Today, I'll cover our results for Q1 and our current outlook for the full year before opening up the line for your questions. You can refer to yesterday's press release and the investor materials posted to our website for the full detail on our Q1 2021 financial performance. We continue to witness resiliency in our markets. First quarter recurring revenue grew roughly 1% on an organic basis despite the tough compare to Q1 of last year, which was largely pre-pandemic. This was driven primarily by continued strength in online payments, particularly in the U.K.

We also incurred a favorable foreign currency impact for the quarter. Our contractual recurring revenue remains healthy, with customer retention holding at 93%, and year-to-date renewals tracking in line with 2020 performance. As expected, the shortfalls in bookings that began at the start of the pandemic are putting pressure on our contractual recurring revenue growth in the near term.

That said, we're optimistic this pressure will abate as we progress through '21. We had a solid bookings performance in the first quarter, which came in ahead of plan and Q1 2020, and we're seeing a healthy pipeline heading into Q2. Onetime services and other revenue declined $6 million, which was approximately a 300 basis point drag on total revenue growth. As we noted in our March investor session, onetime services and other revenue has decreased with a 4-year negative CAGR of 18%, from 2016 through 2020, which has been a material drag on overall growth, but positive for the long term. We expect this drag to bottom in '22, which should result in a lift of a couple of points on total revenue growth in the future.

Turning back to '21. As Mike mentioned, we're gaining confidence that we could see upside to our best estimate for the year based upon the solid start to the year, and thus, our downside scenario is looking very unlikely. Looking ahead, macro-level drivers, coupled with pent-up demand and increased level of online giving, create opportunities for us to achieve low to mid-single-digit revenue growth as early as 2022.

Moving to earnings. Our first quarter gross margin was 59.4%. We generated adjusted EBITDA of $57 million, representing an adjusted EBITDA margin of 26.1% and diluted earnings per share of $0.68. The evolution of our go-to-market strategy with a digital-first mindset has substantially reduced our go-forward cost base in sales and marketing. The first quarter was a solid indicator of our ability to drive bookings performance while reducing customer acquisition costs, and we remain committed to further improving our CAC payback period and increasing sales velocity.

We are also continuing to make critical investments in the business related to areas like digital marketing, engineering, security, customer success and our continued shift of cloud infrastructure to third-party cloud service providers. Our current plans calls for the level of investment to increase in the coming quarters, and thus, our estimate of roughly 25% adjusted EBITDA margins holds as our best estimate for the full year '21.

That brings me to the cash flow statement and balance sheet. Our Q1 free cash flow was $17 million, an increase of $55.6 million year-over-year and representing a free cash flow margin of 7.9%. I'll remind you, historically, we have typically been a net borrower in the first quarter prior to switching more of our compensation plans to be equity-based. We ended up the quarter with $523 million in net debt. Our capital strategy calls for a debt-to-EBITDA ratio of less than 3.5x. And at the end of Q1, we stood at 1.8x, which is our targeted optimal leverage ratio, and we had $406 million of borrowing capacity.

In the first quarter, we repurchased approximately 466,000 shares of our common stock for $28 million. And as of March 31, we had approximately $181 million remaining and available under our current share repurchase authorization. As we look forward, we plan to opportunistically execute on share repurchases when our internal estimates determine that the company shares are undervalued by the market. Future share repurchases could also be used to offset dilution related to our equity compensation programs. As a reminder, our recent share repurchases offset roughly 3 years of dilution related to our decision to shift our company bonus plans from cash to equity.

To summarize our outlook for 2021, from a revenue perspective, we're encouraged by the solid start to the year and the durability of our recurring revenue streams. As we've said previously, the obvious challenge continues to be to accurately predict the duration and magnitude of the pandemic and the ultimate impact on our revenues. In particular, the heightened level of variability in transactional revenue makes it difficult for us to put out definitive guidance ranges like we've done in the past. But I do want to provide current perspective on our best estimates for 2021 and the scenarios we laid out on our Q4 call.

Our latest modeling gives us additional confidence in our best estimate and suggests our upside scenarios are looking more likely. This is inclusive of an anticipated $15 million to $20 million decline in onetime services and other revenue. Contractual recurring revenue, which is the core of our business, is expected to grow modestly in 2021, and we're optimistic that will set up for an acceleration in revenue growth post-pandemic.

After a solid Q1 bookings performance, we expect to see a pickup in bookings in the second half of the year, and we're encouraged to see progress with the vaccine rollout, which bodes well for a quick recovery in the transactional revenue tied to in-person events. The trends we're seeing to start the year, combined with favorable foreign exchange rates, significantly reduces the likelihood of our downside revenue scenario.

Shifting to profitability and cash flow. We continue to progress on initiatives like the migration of our cloud infrastructure to third-party cloud service providers, which we expect to result in future gross margin improvement as we're able to reduce our own COLO footprint and the associated duplication costs. The enhancements we're making in our go-to-market will significantly reduce the payback period for our customer acquisition costs while increasing sales velocity. And I do not expect our sales, marketing and customer success expense to return to pre-pandemic levels.

Also, our work in 2020 to optimize our real estate footprint will generate approximately $14 million of annual cost savings going forward. Our most likely scenario calls for an adjusted EBITDA margin of approximately 25%, and this is inclusive of several cost actions taken in 2020 that will not repeat in 2021. While revenue remains somewhat variable in the near term, we're confident in our ability to manage costs and ultimately profitability across various revenue scenarios.

Our pivot to place a greater emphasis on profitability positions us to significantly improve on Rule of 40 in a post-pandemic environment and gives us heightened confidence on our expected future free cash flow generation. The potential for near-term variability in transactional revenue and bookings makes it a bit difficult to be precise in our free cash flow estimates for 2021. With that said, we feel very confident the floor for free cash flow is $100 million for '21, and free cash flow could vary materially to the upside depending on how bookings rebound this year and when in-person events return.

We will also continue executing against our capital deployment strategy, which calls for ensuring access to adequate levels of capital to grow the business through balance sheet management, rigorous oversight of investments in the business, including acquisitions, and identifying and efficiently returning excess capital to shareholders, including the option for additional share repurchases.

In summary, Q1 was a solid start to the year and positions us well for a strong 2021. We have increasing visibility into our near-term performance. And as we exit the pandemic, we see significant growth opportunities ahead of us. As we outlined on our recent investor session, we have 10 key growth drivers already being worked throughout the business, and we are increasingly confident in our ability to hit our mid- and long-term growth goals. Accelerating growth, combined with other margin expansion initiatives, put us on a path to achieving the Rule of 40. And our proven capital strategy, which includes continued M&A and our newly expanded share repurchase program, provides us with ample optionality to allocate capital in a way that maximizes value for our shareholders over the long term.

With that, I would like to open up the line for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Brian Peterson at Raymond James.

Brian Christopher Peterson - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

And congrats on the strong bookings and a good start to the year. So I wanted to double-click on the go-to-market. It looks like with the bookings, you've had some success this quarter. I know we've talked about the digital motion. T&E has been kind of an interesting thing with COVID. But we've seen the sales and marketing line decline a lot over the last several quarters. So I want to understand how you're thinking about that go-to-market motion and the ability to tackle those growth opportunities over the next few years.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes, sure. Brian, hey, it's Mike. Good morning. Thanks for the question. Yes, we've had a multiyear effort around optimizing our customer acquisition cost and investing in our digital capabilities with several new platforms and new leadership on the digital side, and we've seen productivity increase quite a bit. We've had really good improvements in bookings, a good quarter this year in the first quarter to plan, and growth over last year's first quarter. And last year's Q1 was largely not in the pandemic. So we feel pretty good about the increase in productivity and kind of where we're going related to that. Our focus is on driving organic growth and bookings, and so we're making those balanced decisions. And so far, we think it's working out quite well.

Brian Christopher Peterson - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Great. Good to hear. And maybe just comments on -- obviously, your commentary on bookings and the renewals, how much in a typical year -- and again, I know we're still in COVID here, but how much in a typical year do you see the bookings come in the first quarter or the renewals come in the first quarter? I'm just curious how meaningful that data point is as we think about kind of a full year of bookings and renewal activity.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. Brian, it builds, so Q1 is always a low quarter for bookings for us. And from a renewal standpoint, it's kind of a Q2, Q3, end of Q2, beginning of Q3, is a spike in renewal activity. We talked a lot about that in the Q2 call last year because we're in, obviously, the middle of the pandemic, and people were worried about renewals. And we exceeded our plans last year in that time frame.

And so that's every year, typically, for us, bookings start off budgeted low because the activity is just low for the markets we serve, and then it builds. And we did well this year in Q1. And again, renewal, the biggest activities, back half of Q2, Q3. And last year, we did really, really well. So we don't anticipate any change there. And our retention rate, just to remind you, went up last year from 92% to 93%.

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

And Brian, I would just add, obviously, Q1 is very important as is Q4 last year just from a Rule of 78. From a bookings perspective, that's been so much of the business being recurring. And so it's -- although a seasonal low is still a very good indicator, right, of where we're off to the year. And exceeding plan is exciting for us, and that's why it allows us, I think, that and the renewal rates, to look at the downside scenario and largely take that off the table.

Because if you recall, when we spoke about that on the last call, that was assuming that things fell apart and that the vaccine rollout was not going well and that transaction volumes might fall off even further and bookings and pipeline drop off. And so to see a positive start largely allows us to take that downside case off the table.

Operator

Your next question comes from the line of Ryan MacWilliams with Stephens Inc.

Ryan Patrick MacWilliams - *Stephens Inc., Research Division - Research Analyst*

As just a follow-up there, can you talk about how bookings trended during the quarter? I know they tracked ahead of plan overall. But just curious to see if you're seeing bookings improve each month as a return to normalcy in the pandemic.

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

Ryan, I don't know that we're seeing anything unusual from a trend perspective. That being said, we would have projected an upward into the right trends throughout the entirety of the year. So if you recall, because we're in the pandemic, we're anticipating that we'll have a bigger recovery in the second half, assuming things start to get back to normal with the vaccine rollouts and the economy opening back up. And so we're kind of back end-loaded.

So everything really is, plan-wise, was kind of upward and to the right throughout the year, with a bit more hockey stick per se this year for bookings in the back half just because we're assuming things start opening up more from a pandemic perspective in the second half. Same with the -- the other thing would be on the transaction side. We've spoken about that as we expect to see mass participation events start to open back up in the second half as well.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

But it trends upward, Ryan. We budget it that way every year. From the first month, from January, through the year, it moves up.

Ryan Patrick MacWilliams - *Stephens Inc., Research Division - Research Analyst*

I appreciate the color. That makes sense. And helpful from a bookings [linearity] -- standpoint. And now look, this one is a little more higher level. And I know it's still early, but do you have any thoughts on how the potential changes in Biden's tax policy could impact charitable giving maybe at the end of this year and into next year?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. I just look back at all of the administration changes over the years and the size of the giving market. And just in the U.S., in 2019, it was $450 billion. It's such a huge market, and it's pretty much tracked U.S. GDP for over 40 years. And so it's such a big number. And even when we've had tough economic times, '07, '08, it kind of goes backward a point or stays roughly flat and then comes right back to a normalized GDP, not last year's. And so it really hasn't ebbed and flowed that much based on tax changes per se.

And frankly, it's so big, and we capture such a small part of it, that even if it ever did go backwards, I wouldn't be all that concerned because it's so big. But then again, it's never really gone backwards based on those changes. So we feel pretty good about being able to get more of that in the future. And the shift to digital has been a big move in the last year as well, which was really positive for us also.

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

Yes. And I think, Mike, if you look back at like the '86 Act, which put in some of the first limitations on itemized deductions, giving bounced a little bit in the next year, but not significantly, to your point. And then last year or 2 years ago, we were talking about with the changes that they made again to the deduction and deductibility, thought we might have a change there. And we really didn't see that. We saw a very positive year overall in giving.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. And remember, that $450 billion, I think the number is 73% of it, is they're all small transactions. Those -- most of it is a few hundred dollars. It's high frequency. It's a very retail-oriented sort of motion, and that's what we're digitizing and that's what's sort of the flow that goes through our systems, not major gifts, right? So -- and folks that are donating $50 or $100 to something they care about don't really think about the tax implications of that per se. So it doesn't -- the laws that change has never been a concern for us. And I anticipate that's going to be the case here as well.

Operator

Your next question comes from the line of Tom Roderick with Stifel.

Jeffrey Parker Lane - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

It's actually Parker Lane on for Tom. Mike and Tony, as you think about the balance of payments revenue, you've seen a nice acceleration in that as payments shift to online methods. And as you [come] to the rest of the year and reopening and what that's meaning for transaction revenue, how much durability do you think there is in that shift to online payments? Do we get back to levels that we've seen pre-pandemic? Or do you expect that to always be a little bit higher than we saw as your end customers have gotten more comfortable with those fundraising methods?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. I would say that it's -- it was a big move last year. It took decades to get to 9%. And last year, we went from 9% to 13% in 1 year. And we don't see that going backwards per se. It's sort of equivalent to the rest of the online payments and digitization that's going on in all industries. Consumers are used to that. They're used to doing things on a mobile device. 1/4 of those transactions last year were on a mobile device.

And so those macro changes that all, sort of, digital payments companies talk about is the same here because it's the same end consumer, if you will, conducting their lives on a mobile device and their personal financial lives and making donations that way. We don't see the behavior going backwards because it's common across everything else that happens. And so that bodes really well for our markets, our customers and for us.

The other thing that's happened is a lot of our customers switched to virtual events. And there's a lot of sort of the traditional nonprofit customers that had in-person events, they're going to go back to in-person events, but they're also going to keep the new virtual events going as well. So we see the in-person events coming back in the second half of the year, but we also see the intermittent digital virtual events continuing as well because they exclusively did a lot of those last year, which also is tied to your question on payments.

Jeffrey Parker Lane - *Stifel, Nicolaus & Company, Incorporated, Research Division - Associate*

Yes. That's very helpful. And maybe quickly on the M&A opportunity. I know you mentioned you're constantly evaluating new opportunities to expand your market, looking for good fits culturally and from a technology standpoint, but are there any signals in your end market that you would need to sort of give the greenlight on an M&A deal? Or do you feel like you're there today?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. I don't think we have to buy a company to accomplish our current objectives that we've laid out. However, we're always looking at opportunities to add value to our portfolio and for our customers. And the acquisitions we've made, also, in a lot of cases, have made the existing product portfolio stickier for us as well. We've really gone, in a lot of our markets, to a integrated portfolio approach as opposed to a stand-alone solution. And so we continue to look at opportunities related to that.

But your question was, do we think we need to do a deal for our portfolio and our financial outlook. The answer is no, we don't need to, but we remain quite active. And I think Tony mentioned in the prepared remarks, our debt-to-EBITDA ratio is down to 1.8x now. So we're in a good spot. We recapitalized the company last fall. So we're in a pretty healthy spot to continue to be proactive there as well.

Operator

Your next question comes from the line of Mark Schappel with Benchmark.

Mark William Schappel - *The Benchmark Company, LLC, Research Division - Director of Research & Equity Research Analyst*

Mike, your tone towards your business continues to improve, and that's good. And I was wondering if you could just go into some greater detail with respect to what you're seeing in your business that caused you to be more positive. So for example, are you seeing improved responses to outbound marketing campaigns or webinars? Are customers choosing to do more virtual meetings or upsize [their] deals? Maybe if you could just go into a little detail there.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes, Mark. Sure. It's kind of a combination of things. On the sales bookings side, we talked about that, a good quarter, lower CAC costs, good bookings quarter to plan higher than last year in a non -- largely nonpandemic Q1 last year. On the transaction side, the jump in 4 points in online giving is positive for us. The trends there are positive and then the events planning happening that we could see for the back half of the year.

One example is on our JustGiving platform, we have account managers that are assigned to customers that help them get ready for future events, and we're seeing that activity happening on the platform for the back half of this year. We see that being -- those events being created to ready to be executed in the back half of this year. And so we can see all of these things in the business and in the systems that point toward a pretty good outlook for the rest of the year.

Mark William Schappel - *The Benchmark Company, LLC, Research Division - Director of Research & Equity Research Analyst*

Great. Helpful. And then during the Investor Day, you mentioned that you thought there was an opportunity for price increases around your solutions and if I recall correctly, [even with some] solutions, you thought you could see some meaningful price increases. I know it's still early, but I was wondering if there's any update on that front.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. We have a couple of activities going on there, Mark. And a lot of -- some of [this is] really kind of catch-up. We had some planned a year ago or so when we put it off because of the pandemic, and we're pretty good at understanding what the market looks like, what the competition looks like. And frankly, we're behind in a couple of areas. So in a couple of areas, we're just going to kind of meet what's happening in the marketplace, which is beneficial for us and kind of market-neutral from a competitive standpoint.

And so we're executing on those. And one of them is a model that we built over several years and deployed very successfully in the U.K., that's fully underway on the JustGiving platform, that we're just taking that model to the U.S. market. That one is super interesting as well because it actually lowers customer cost and increases our revenue. So it's definitely a win-win, and it's been deployed really successfully in JustGiving, and we're going to move it to the U.S.

It's going to take some time. These aren't necessarily like throwing on a switch. In some cases, some it is. Some of it's driven by adoption and takes some time. But I think there's a big opportunity across the multiple pricing initiatives, and they're not just price increase, they're structure changes, like the one I just described in the U.K., coming into the U.S., that again benefits the customers and us in the long run. And I think there's big upside in all of those.

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

And I think, Mark, the timing of those, of the -- the long end of the tail on those is probably 3 to 4 years on the longest because you go through renewal cycles on some of the pricing things. So if folks are on 3-year contracts, you'll have to wait until that renewal comes up. But to Mike's point, some will be more immediate and near term. But the length of this, we'll be talking about this for the next several years.

Operator

Your next question comes from the line of Koji Ikeda with Bank of America.

Koji Ikeda - *Bank of America Merrill Lynch - Analyst*

I wanted to ask -- dig in a little bit on a prior question about this gradual return to events and thinking about the monetization of in-person events as we gradually get back to normal here. Overall, it sounds like we're going to start to have some sort of in-person events soon, but maybe at reduced capacity rates. However, over the past year, it seems like people have become increasingly more comfortable with digital engagement, too.

So as you're having conversations with your customers about the return to normal, how should we be thinking about the monetization of events, that will likely have some sort of hybrid in-person and virtual component as we're gradually returning to normal?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes, sure. And they're a little different, right, because events are really wide. An in-person event can be a one-night dinner gala, or it could be some of our customers have thousands of bike rides or 5- or 10-K runs or walks. So events is a really wide category. But our platforms for in-person events, we monetize those through usage of systems, and then payments as well is a part of it. And so it's a mix. And again, we see that growing in the back half of this year as we can see them being planned.

And so some of the events, as I mentioned earlier, we might have some customers that have sort of one big gala a year. And last year, they went and they did multiple digital events, virtual events, and they're going to put that gala back on, right? But they're going to keep doing the virtual events, which they might have never done before in between the galas to keep driving their revenue because they learned how to do that.

And so those kind of institutions might have a mix. The institutions that have the 10-K runs or the walks, might go fully back, right, to those in-person, but they've also gotten really smart about virtual events as well. And so now they've sort of increased their arsenal on revenue generation with being smart and more experienced on virtual. So we see virtual continuing, and then we see the in-person ones coming back. And it's based on the kind of events. They're going to have a mix. And we see all those being planned, and we think that's positive for our customers and for us as the year continues as well.

Operator

Your next question comes from the line of Matt VanVliet with BTIG.

Matthew David VanVliet - *BTIG, LLC, Research Division - VP & Application Software Analyst*

I guess as you look out kind of over your plan across '21, curious which verticals may be or which bigger kind of industry areas do you expect have the biggest potential inflection point. I imagine things like arts and cultural relative to last year, where their doors were completely closed. And you have museums and things like that opening, at least at partial capacity, is a big upside.

And -- but maybe just help us walk through kind of what some of those big buckets are that have potential upside and then within that, just kind of how the Church Management program and the buildout of that sales team is progressing as one particular highlight.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Sure, Matt. So from a comeback this year, tied to openings and vaccines, the sharpest will be all of our existing customers, and you mentioned like performing art centers, that are customers that haven't had activity. And we're going to see the benefit of that because these are folks that have been customers, in a lot of cases, for years, and their business went dormant and they had a tough year last year. And again, our revenue is payments- and usage-based. So those scenarios, there's no selling motion and implementation motion. They're live. They're ready to open their doors. So performing art center is a good one because our platforms handle not just donations, but tickets and ticket sales in that vertical.

And then the events I talked about, if you're not having events and you all of a sudden have events, you're already on our platform. It's an instant turn-on of your donation revenue, therefore, usage and payments. So those are sort of automatic and instant, and so those will be the fastest returns to generating growth for us.

Related to faith based, yes, we have a dedicated team. We've got a portfolio sell going on there now. So we're actually doing really well in our Financial Edge NXT platform in that space. We continue to build out the Church Management platform. Fundraising, doing well in that space, and analytics. So it's a portfolio sell approach, and we do have a dedicated team that we've built up over the years.

Matthew David VanVliet - *BTIG, LLC, Research Division - VP & Application Software Analyst*

Great. And then following up, I know we've had a lot of questions on the payments, but it seems to be an area of a lot of opportunity. Can you just remind us, kind of generally speaking, what the attach rate is of current customers that have enabled the payments function? And kind of what, if any, opportunity is there to add that on further in '21, I guess, relative to maybe what growth looked like in '20 in terms of customers adding that on that didn't previously have it?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes, Matt, we haven't broken out attach rate historically for existing customers, but we do have a team of folks that focus on cross-selling to existing customers, and then the entire sales team bundles payments out of the get-go as well. And then lastly, this digital shift we've seen, I think, is a permanent growing shift in the space, which is a driver for payments. But specifically, we don't break out the attach rates.

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

And I would say, though, Matt, is as we bring this new offer that we've been doing in the U.K. to the U.S., it's going to give us another competitive advantage on the payments front. I think we've got a good offer. We charge the one rate, and it's very simple. We don't worry about card present, card not present. So we've made it straightforward and clean. I think this new offer that's beneficial for our customers and for us will give us a bit more differentiation there, which hopefully will drive more payments.

And I think the other [one is a] lot of folks have had our payments platform, did not necessarily process a lot of volume. [And you can speak of] like the church space, a lot of that was still cash in hand and checks at your service or at mass, they were forced to go to digital last year in the midst of the pandemic to online offertory. And so we think those things will have long-standing tenure.

And the last thing I would mention is when folks are using payments, as we've said before, it typically improves our retention rates when they have multiple products or services. So that's also a very positive for us. [It] all points in the right direction, obviously.

Operator

Your next question comes from the line of Ryan MacDonald with Needham & Company.

Ryan Michael MacDonald - *Needham & Company, LLC, Research Division - Senior Analyst*

Mike, I wanted to double-click on the commentary around the success within the higher ed institutions for Blackbaud CRM during the quarter. What do you think is driving that? Is there sort of an increased need with the financial stress of these universities from the pandemic to improve or step up their game on fundraising? And is Reeher, I guess, as it's been integrated into the platform, is that having -- helping your win rates there?

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Yes. Yes, it is. And yes, to your first question. So the marketplace in higher ed has become more and more focused on fundraising and using that. And you see a lot of the leaders in higher ed, the university presidents, getting more personally involved in that as well. And so it's becoming a major component. And we just have a really solid platform there. It's been in the space for years. It's purposely built for fundraising for larger institutions. It's what we call Blackbaud CRM. It's not a general-purpose CRM, it's used for fundraising exclusively.

And in higher ed, it's becoming sort of the standard, and the results are fantastic related to folks that use our platform versus folks that don't because it has detailed capabilities to drive revenue for higher ed institutions and other verticals as well, large nonprofits and health care. But we've got a lot of runway ahead of us and a lot of success globally in the higher ed space with that platform, lots of capabilities. We've opened it up with more APIs recently. We've got more partners in there. We've got third parties building apps there. And for our other solutions like Raiser's Edge NXT, frankly, in the marketplace. So yes. It's a very successful platform, and it's well known in that industry as well, [to be that platform].

Ryan Michael MacDonald - *Needham & Company, LLC, Research Division - Senior Analyst*

Great. And a follow-up for Tony. I wanted to -- kind of focusing on the gross margin performance in the quarter. Obviously, a nice expansion year-over-year. Can you talk about what the mix, what it was driven by, between whether it was mix shift from -- away from onetime services or perhaps some of these -- the migrations to cloud hosting starting to impact? And how should we think about that gross margin evolution over the next year?

Anthony W. Boor - *Blackbaud, Inc. - Executive VP of Finance & Administration and CFO*

Yes. Good question, Ryan. The unfortunate thing, I think, onetime services and others hit us a little hard this quarter. That revenue drop continues to put pressure on the gross margin on that line item. There's a lot of moving parts in there, but you can see on a GAAP basis with our earnings release, that it was significantly negative this quarter. So it actually -- while it helps us from a mix perspective as it continues to shrink, this quarter's performance put a bit of pressure on gross margins. We've had really good positive headway made on the move to third-party cloud providers' environments. We're seeing a cost per unit decrease already that's having a positive impact. That said, we still have a lot of duplicate costs that are weighing on margins.

To get to your longer-term question, we would expect to see kind of some steps along the way as we get off some of the old tech stacks and get chunks of our products' move to third-party cloud providers seeing an improvement in gross margins. And then the wildcard is going to be a bit of mix. I think the interesting thing with these new pricing initiatives that we talked about at the investor session and talked about earlier on the call, those should all be very accretive to margins.

The donor cover tip jar discussion related to JustGiving, moving that to the States, really positive for our customers for the amount of revenue they bring in from each donation dollar and improves our profitability and certainly helps our margin structure on the payments side. So that will be positive.

And then the other pricing changes, as you know, where Mike talked about just getting to par with competitors, there's really no incremental cost that comes with those. And so those are largely all profit dropped through to the bottom line. So I would expect we've got several things in the works over the next few years as part of this grander strategy that will help improve gross margins as well as operating margins and cash flow.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session, and I would like to turn the call back to Mr. Mike Gianoni for closing remarks.

Michael P. Gianoni - *Blackbaud, Inc. - President, CEO & Director*

Thanks, operator. I'll just close by saying we have a lot to be excited about based on our start to 2021. A second half recovery is looking more likely, and I believe we're uniquely positioned to elevate our status as a leader in the market.

Looking ahead, we have multiple levers with which to accelerate revenue growth and margin that span across 3 areas: first, pandemic recovery with event-driven transactional revenue and bookings returning post-pandemic; second, a few price model and price catch-up opportunities that we discussed at the investor session; and third, we remain active in looking at M&A opportunities.

We believe the steady execution against the Rule of 40 financial framework and our continued commitment to disciplined capital deployment will generate substantial shareholder value. We look forward to providing a more comprehensive update on our initiatives to accelerate long-term performance at our next call. Thanks, everyone.

Operator

This concludes today's conference. You may disconnect your lines at this time. And thank you all for your participation.
