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PRESENTATION

Operator

Good day, and welcome to the Blackbaud, Inc. Second Quarter 2019 Earnings Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Mark Furlong. Please go ahead, sir.

Mark Furlong - *Blackbaud, Inc. - Director of Investor Relations & Corporate Finance*

Good morning, everyone. Thanks for joining us on Blackbaud's Second Quarter 2019 Earnings Call. Today, we will review our financial and operational results and provide commentary on our performance in the context of our 4-point growth strategy. 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, I'll briefly cover our upcoming investor marketing activity, which is available on our Investor Relations website. During the third quarter, our team will be attending Oppenheimer's Technology, Internet & Communications Conference in Boston; Canaccord's Growth Conference in Boston; KeyBank's Annual Global Technology Leadership Forum in Vail, Colorado; and D.A. Davidson's Vertical Technology Conference in New York. We will also be holding meetings with investors in Montréal and Toronto. And finally, please mark your calendars for October 16 where we will again host investors and analysts for a breakout session with management at our annual user conference, bbcon, being held in Nashville, Tennessee.

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

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

Thanks, Mark. Good morning, everyone, and thanks for joining our call today. With the first 2 quarters of 2019 behind us, I'm pleased with our progress as we continue to deliver vertical-specific software innovation, enabling our customers drive impact and outcomes across the markets we serve. We're in a unique position helping organizations around the world drive digital transformation and enabling our customers to realize their full potential. Last week marked our 15th year as a public company, which is a testament to the incredible team we have and our dedication to building a better world while driving shareholder value. We have a global workforce of over 3,300 employees, of whom nearly 25% sit on nonprofit board or committee, 9 out of 10 say Blackbaud's mission was an important factor in joining the company, and over half say that volunteerism has increased since joining Blackbaud. This mission-driven culture not only drives innovation and customer satisfaction, but it's also an incredible asset for our recruiting efforts. We're proud of what we've accomplished over the past 15 years as a public company, and we're energized by what's ahead as we continue to rapidly advance our existing applications and bring new solutions to market.

Heading into the second half, our full year financial outlook is unchanged, and we are reaffirming our 2019 full year guidance. As usual, Tony will provide more detail on our results, and I'll provide an update on the context of our 4-point growth strategy.

The first of our 4 strategies is integrated and open solutions on the cloud. The customers we serve require vertical-specific business solutions to automate their operation, and we build integrated purpose-built cloud solutions that follow these business needs. As an example of our execution against this strategy, we developed Blackbaud Church Management, part of the Cloud Solution for Faith Communities, enabling churches to digitally transform their day-to-day operations through a single connected experience. We've been working with churches to gain additional insight into the capabilities they need to be successful and continue to incorporate their feedback to optimize our already-robust technology platform specifically for their needs. We have heard from our Early Adopter customers that our solutions stand out as intuitive and easy to use with a mobile responsive user experience.

Churches can also add other Blackbaud capabilities from the Cloud Solution for Faith Communities as their needs scale, all through 1 integrated experience which is powered by the Blackbaud SKY platform. Bringing this solution to market is a significant step towards addressing several challenges in a church market and a substantial opportunity for Blackbaud. This major initiative is on track, and we expect to announce general availability soon.

The momentum is also building on our Blackbaud's best-in-class peer-to-peer fundraising solution powered by JustGiving. Since the U.S. launch in March, several hundred customers have signed up, creating a growing number of active campaigns, and I'll note that majority are net new payment transaction customers for Blackbaud. It's early days, and we're excited about the opportunity to truly disrupt the market landscape by providing this peer-to-peer cloud solution, which is fully integrated across our portfolio of best-in-class cloud solution. This is unique in the marketplace, and there isn't another platform like it.

Turning to our second growth strategy, which is to drive sales effectiveness. As you know, we have worked to simplify our program, refine our methodology and approach in a uniform way to better enable our salespeople for success. The sales structure transformation is now largely done, and we are laser focused on adding additional sales headcount and improving overall sales productivity. Our plan this year accounts for a continuation in a heightened level of sales hiring as we go after the large opportunities we have across our vertical markets, and Tony will provide an update on those investments.

Our account executives continue to lead the total solution selling by vertical, focused on reoccurring revenue and driving more products for customer, higher ASPs and overall increased customer lifetime value. Selling comprehensive cloud solution translates to real value for our customers.

For example, St. Stephen's Episcopal School in Austin, Texas recently undertook a vendor evaluation with 1 goal in mind: to consolidate the number of systems that students and parents use to interact with the school, a critical project for the first coeducational episcopal school in the United States with over 650 students enrolled from 14 countries and alumni dates exceeding 6,000. After an exhaustive evaluation process to create a vendor list reaching into the double digits, St. Stephen's ultimately selected Blackbaud because "fewer systems need less time spent on software maintenance and data synchronization as well as less time spent training teachers, students and parents." They also highlighted our Open API as a differentiating factor given a tight integration with partners to provide ancillary services.

We also continue to rapidly advance our existing applications through new solutions to market, enabling our sales teams to sell more. Our higher education vertical is a great example where we have extended our proven K-12 private school solutions upmarket with significantly advanced functionality, enabling us to provide broad cloud solution to manage a complete student life cycle for admissions, student information, learning management through alumni engagement and more all inside 1 cloud platform. This is unique in a higher ed market, and we've been pleased with the early traction. In fact, the majority of customers signing up for our education management portfolio this year purchased 4 or more products.

I'll now turn to our third strategy, which is TAM expansion. We continue to be excited about the acquisition of YourCause this past January and the inclusion of their industry-leading corporate social responsibility offering, which puts our business in a unique position to drive increased connectivity and efficiencies that have never been seen in this space. As you might expect, we moved fast on back-office integration as we focus on the opportunity ahead of us, which is significant given the trend of institutions of all sizes focusing on corporate social responsibility. This is a fantastic business as reflected in their existing customer base as well as the new customer for signing up with organizations like the NHL Foundation and the Philadelphia 76ers who recently selected YourCause and Blackbaud to help power their philanthropic efforts. And I'll note there's opportunity to extend beyond just companies and into markets we already serve like health care and higher ed institutions.

Our total addressable market currently stands at over $10 billion, and we remain active in evaluation of opportunities to further expand our TAM through acquisitions and internal client development.

Our final strategic initiative is a focus on operational efficiency to strengthen the business and position us for long-term success. This continuous effort spans the entire organization as we drive towards a more scalable operating model that creates efficiency and consistency in how we execute through infrastructure investments, productivity initiatives and organization alignments. An excellent example is our recent heightened investment in sales hiring. We spent the last several years in sales creating 1 global sales operating model to enable our account executives to sell more efficiently, but we also designed the program with scalability in mind. Our sales operating model enables us to efficiently recruit, hire, train and track the progress of a growing sales team in a way that we couldn't have done just a few years ago.

Overall, I'm pleased with our execution through the second quarter; our continued shift towards reoccurring revenue, which now stands at 92% total revenue; and the opportunity ahead of us in 2019. Our full year financial outlook is unchanged, and we are continuing to execute against our strategic plan, which is strengthening the business, enabling us to deliver more specific innovation for our customers.

I'll now turn the call over to Tony to cover our financial performance in greater detail before we open it up for Q&A. Tony?

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

Thanks, Mike. Good morning, everyone. Please refer to yesterday's press release and the investor materials posted to our website for a full detail of our Q2 financial performance. Today, I'll focus on key highlights, so we can get to your questions.

We continue to see a healthy shift in revenue mix, and as Mike mentioned, our second quarter recurring revenue represented 92% of total revenue. Recurring revenue increased 8% over Q2 of 2018 and 5% on an organic basis. Onetime services and other revenue represented only 8% of our total revenue mix and declined nearly $4 million in the quarter, which is an 18% decline versus Q2 of 2018.

During the first half, onetime services and other declined 21% compared to the first half of 2018. And we still anticipate the rate of year-over-year decline to accelerate to roughly 25% for full year 2019, which is healthy for the long run.

I'll remind you that last year, onetime services and other declined 17%.

Turning to profitability. Our second quarter gross margin was 60.8%. We generated operating income of $43 million, representing an operating margin of 19.2% and diluted earnings per share of $0.66. I'll point out that the strong operating performance in the first half includes heightened investments and positions us to land within our full year guidance for operating margin of 16.7% to 17.2%.

As Mike mentioned, our plan calls for continued hiring as we look to grow our full year sales headcount at an accelerated rate relative to our historical average, and we're pleased with the progress of the new hires added to date as they ramp to targeted productivity. With 2 quarters behind us, we expect the level of investment and pace of sales hiring in the second half to exceed our first half investments as we further expand our selling footprint, bring new solutions to market and continue our shift to third-party hosting.

Moving to the cash flow statement and balance sheet. Our Q2 free cash flow was $38 million, which puts us on track to deliver our full year guidance of $124 million to $134 million.

We continued making necessary innovation and infrastructure investments to support our move to the cloud amounting to $5 million in CapEx, primarily associated with our global workplace strategy and investment in infrastructure and $12 million for capitalized software development.

During the quarter, we paid out $6 million in cash dividends to shareholders and ended with $529 million in net debt. Our capital strategy calls for a debt-to-EBITDA ratio of less than 3.5x. And at the end of Q2, we stood at just under 2.7x.

In summary, continued execution against our strategic plan is allowing us to strengthen the business and reiterate our full year financial guidance. We're maintaining our disciplined approach to balance investments to drive growth with improved profitability, and we will continue to execute on our capital deployment strategy to maintain a strong balance sheet, return capital to shareholders and create growth and scalability.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now move to our first question. Please go ahead, caller.

Thomas Michael Roderick - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

So I wanted to kind of start here with the big upside in earnings and margins, congratulations on that. Great job in terms of profitability this quarter. But I'm hearing you loud and clear, Mike, when you say the heightened investments need to continue here. So I was hoping you could talk about that just a little bit. And in terms of last year, I think you guys hired somewhere in the ballpark of 80 or a little bit more than 80 reps in the back half of the year. You jump-started faith-based. You jump-started higher ed. How many more reps or what's the sort of scale that you think you need to kind of get those businesses scaled out? And as we look at sort of the implied guidance, obviously, it pulled the margins back into the 16, high 16s range for the rest of the year to kind of hit that guidance. How do you want us to think about the longer-term approach? It sounds like you want to keep heightened investments for a while. Or could 2020 be where we to see a little bit more leverage? Just take us through the midterm thinking and what the scale on these sales hires need to be to kind of get the faith-based and higher ed up to the scale that you need?

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

Sure, Tom. I'll start here. A couple of things. First of all, the investments in the platforms themselves are -- indeed, are going really well, and the market acceptance is really great on both faith-based and higher ed, and we expect to be announcing general availability in both of those in the next couple of months. So they're going really well, Early Adopter customers on both, so those investments are moving well.

We also have, over the last 12 months or so, increased sales headcount, as you mentioned, 84, I think, people in the back half of last year. Some of those increases were in those 2 markets, higher ed and faith-based, and some other markets as well. And we continue to plan on increasing headcount in sales. It'll be a little bit back-end loaded this year, the ramp-up in sales headcount. We plan on smoothing that out more in future years, like next year where headcount ramps won't be as lumpy. We hired a bunch of folks in Q4 last year, and then shifted some folks around in Q1 this year. And so the hires -- because of all that change, the net new hires will be more Q3 and Q4 this year. And like I said, we plan on having that piece smoothed out in future years, starting next year, but we continue to plan on investing in sales ramp across the board.

I'll just give you 1 little example. We closed on YourCause in January and not breaking out numbers at that micro level, but we've already doubled the sales headcount in the YourCause space, and we're about to triple it between now and end of the year from the January close with that business. So that's just 1 example where we're kind of doubling down on sales headcount growth because of the opportunities where in that business we're hiring people in major cities given the opportunity that we have.

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

I think, Tom, on the margins side real quick, on the guide, it'll be not only the continued investment in innovation Mike spoke to and the back-end loaded hiring on sales, but we also have some onetime type costs recruiting expenses because of the ramp in hiring, we got some major IT projects that are still ongoing that are a bit more lumpy on consultative-type expenses associated with those projects, some of the integration costs, et cetera. So there's some of those kind of more onetime in nature as well costs hitting in the second half that are heightened versus what we saw on the first half, which helps drive that full year EBIT margin guide down a bit.

Thomas Michael Roderick - *Stifel, Nicolaus & Company, Incorporated, Research Division - MD*

Okay, good. Tony, quick follow-up for you. Just as we lap Q3, Q4, we had a bit of challenges last year, and some of those challenges have stemmed from the payments business, which had kind of been humming along and then you hit some headwinds, some in the K-12 arena with, I think, it was mix shift issue, some in the U.K. around JustGiving. As we lap those kind of headwinds, how should we think about the payments business right now? Has this stabilized? Is it growing at the same rate as the rest of the business? Is it still a little bit of a headwind? Maybe just some details around payments in general and how payments play a role in this quarter.

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

Yes. Sure, Tom. Last year, there was kind of 3 big areas on the payments front that hit us, which was really unusual to the kind of similar time frame the back half of the year we had. The overall U.K. market and softness that we saw there, which, in fact, is more than historical just because of the JustGiving acquisition, that U.K. market has still been soft on the giving front. So that continues. We did a much better job, I think, in forecasting that this year, so we're actually doing well to plan. So no real big issues there.

Smart Tuition, if you call it another one where we just had a mixed shift in mix of parents and affluency in parents. We haven't seen that repeat this year, so that's not really a stability issue. And then we had major onetime events year-over-year where we just had less of those than what we've seen previously. So that one can still be a little lumpy. It's hard to say what hurricanes are going to hit or natural disasters and those kinds of things, so we'll have to see how that plays out. But thus far, we feel really good about where we are on the payments business. So I think the positive side on it is it's -- we've done a good job of going back to the base and penetrating the base since Mike came onboard. And now I do think the growth rate looks a lot more like the rest of the business. We get more selling, enabling payments with the products when we sell them, like the NXT solutions, et cetera. So I think you'll see in the future that being correlated much more tightly to kind of our typical subscription growth, assuming we continue to do a good job of selling payments with and turning on those solutions with each of the products.

Operator

We will now move on to our next question from Mr. Rob Oliver of Baird.

Matthew Steven Lemenager - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

It's Matt Lemenager, on for Rob Oliver this morning. I just had a quick one on the -- a few months ago, we're now a few months into the Salesforce.org acquisition. So I guess, on the competitive front, any changes that you've seen coming out of Salesforce.org given the new ownership structure within Salesforce.com? I realize it's early, but any early changes there?

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

No, haven't seen any. Just to remind you that in many of our markets, we have very different competitors. So our higher-end solution, the competitors are Campus Management, Jenzabar, Unit4 are the competitors that were out there replacing, and faith-based, it's ACS and Perisoft and Ministry Brands. We don't see Salesforce in those markets at all. We don't see them in our performing arts markets, K-12 market, we don't see them. YourCause market, don't see them. Topic comes up a lot, and it should. But we predominantly see them in what I would call pure charities market, and we see no change.

Matthew Steven Lemenager - *Robert W. Baird & Co. Incorporated, Research Division - Junior Analyst*

Okay. Got it. And then on the -- Tony, on the recurring gross margin, ticked down year-over-year. Again I just wanted to kind of ask what's been the trend there? It's been down year-over-year for, I think, 4 to 5 quarters in a row now. Is that more payments going into there? Or what's the trend in the recurring gross margin line?

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

Yes. Rob, it's 2 things. If you recall in Q1 we talked, we had some onetime rebates in Q1 of '18, and that bumped up margins a little bit, which would have some impact on the first half, if you're looking at first half versus last year. And then a bigger really kind of continual trend that you're seeing is not payments, because payments actually, that growth rate because, it's become a bigger base, has slowed and as we said, is more in line with the rest of our business, it's actually more of the move to the cloud, and that we're selling more and more of the new NXT products and moved to third party out of COLO data centers. And we're still getting hit today with our COLO costs plus costs to migrate all of the products to the cloud and then that incremental costs of the third-party cloud. And we would expect over time, we're going to get efficiencies and cost benefits to gross margin from once we migrate all the legacy stuff that will go to the cloud, we won't have those incremental costs of the migrations. When we're able to finish sunsetting or finish migrating the legacy products that will never go to the cloud, we'll shut down the COLO, so we'll have those costs go away. And then as we finish the NXT products completely, Citrix and some of the other things that drive cost in the third-party cloud will go out of those products, and so we'll actually see our average cost per unit drop over time. So I'd expect that we're going to see a bit of a continued increase in COGS for the near term. And in the long term, I would think we should see some positive benefits to the gross margin line as we get more fully shifted to the cloud.

Operator

We will now move on to our next question from Mr. Brian Peterson of Raymond James.

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

So wanted to start on some of the early hires and the sales productivity. You mentioned that you're pleased with the early results. I realize we're early in the process for some of these new people you brought onboard, but I'm curious if there's anything you can expand on that. Maybe what metrics that you're looking at when evaluating the new seals hires?

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

Yes. Sure. So again, we're going to have Q3 and Q4 ramp up again. We really did 2 things in the last 9 months. One is ramp-up in the back half of last year and then some reassignments on the first quarter and deploying folks in direct territories. And a key thing, too, for us is we're roughly now about 50% of the headcount on prospects and 50% on back to base. And we've not been 50-50 before. So that's been a building shift as well.

As far as bringing folks on, not having an issue in finding talent, we get a lot of applicants coming in from lots of different places. Depending on the level ramp time, if you're more kind of mid-level, it's faster than if you're enterprise, just given complexity and size of deals that they're focused on. So I think the ramp is going well. If you just look back the last 9 months or so, I think we've demonstrated we can bring on a lot of folks in a short period, and we plan on doing that in the next 5, 6 months.

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

And Brian, this is Tony. On the metrics, with all these net adds and the reallocation of resources and creation of hunter farmers, all those things, key kind of metrics we look at initially are that ramp to full quota and what our expectations are then. We've seen really nice ramp on all these moves, which is good news, so we're kind of on track for the most part. We've got a couple of isolated pockets in certain verticals where we're not as on track, and we have others where we're ahead of plan. And then we'd look at the mix of recurring versus onetime bookings. We want to continue to shift towards, ARR, obviously for our bookings and for our quota mix. And that's why we changed comp plans and have the 2-bucket approach. We want to sell more new logos. We look at the number of logos we're selling and the mix there. And then at a little higher level, you're looking at ARR to oTE. With our long-range goals, as we've spoke about before, at a company level, we really want to improve that LTV-to-CAC ratio. We're kind of middle of the pack today compared to peers. We'd like to get into that top quartile over the next few years, which means with our retention rates where they are, I think we're in good shape. We'll continue to work on those and try to improve them, but it really comes down to getting more ARR in that ARR to oTE through productivity gains and shift in mix. And so that's kind of the highest level of metrics, but we look at those day in, day out here on the sales team.

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

Got it. And maybe Tony, a follow-up for you. There's -- if I look at the recurring revenue line item, I know there's payments in there, there's maintenance, we got what we used to call the core subscription. I'm just curious, is there any way that you would frame what normal seasonality for the recurring revenue line would look like third quarter versus the second quarter?

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

Yes. With our shift -- continued shift to recurring, we're getting more visibility and should have less lumpiness. The thing that drives the variability really, and there is the maintenance and true subs are not a problem, right? Those are very consistent and typically ratable recognition. The things that are driving some variability are obviously payments and usage and related seasonality. And then within payments, you can have Smart Tuition with the school years and those related seasonality that comes in there. So what we've typically seen obviously is Q2 jumping up a bit from where we were in Q1. Q1 is typically our lowest. Q2, we have some variability also because renewals, which you run into when you start looking at deferreds, because we have a lot more renewals in Q2 and early Q3, which then has a big impact on free cash flow as well because the collections typically come on that heightened renewals in Q3. And then Q4 is typically because of seasonal giving is another quarter that we have some higher-than-normal seasonality. The thing we have to keep an eye, though, is as we continue to roll out these new products, as Mike talked about in higher ed, in faith and then acquisitions like YourCause, is our seasonality continues to shift. And I think what we're seeing is a bit less seasonality now than what we have historically. And I would expect that potential to continue to kind of decelerate in that volatility we've seen historically.

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

Yes. So seasonality is different by vertical markets. Schools won't go live on new platforms in September, for example, given the students are coming back. And faith-based institutions don't make changes around major religious holidays. And so each of the markets has a different cadence around when they buy sometimes but definitely when they go live.

Operator

We will now move on to our next question from Rishi Jaluria.

Rishi Nitya Jaluria - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

I think, first, I want to go back to just the organic growth rates on the recurring side, and I'm sorry if I'm making you belabor a point. But just want to -- I mean, look, it looks like organic recurring growth ticked down a little bit from Q1 and definitely below where it was in the first half of last year. I know we're facing a tougher compare in Q2 versus what you faced in Q1. But maybe if you could just help us understand the puts and takes and maybe why a little bit of a decel. If I'd back into your guidance, it looks like we should expect that metric to tick up in the back half of the year. So maybe help us also understand what's giving you confidence in that number to kind of accelerate a little bit. And then I've got a follow-up.

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

Yes, Rishi. This is Tony. I think on the organic growth rate, it really is a tough compare is what it comes down to because as we spoke to the -- all the new folks we hired in Q4 are ramping kind of right in line with expectations, so we feel really good about the bookings side of the equation. And then because so much of the business is now recurring, that 92% to 93% range, we have really good visibility there, not a lot of volatility in rev rec. The only things that moved in there again is kind of payments and usage related. And we have, like we talked about last year, built some new tools for forecasting those that are much more accurate than we've had historically, so we have really good visibility there. So all things said, it's really that change of 70 basis points is really driven by the compare, the ramp that we're seeing, kind of expectation of our internal plans. We're right on track, so I feel good about our reiterate on the full year guide. I don't know if there's anything else that I can think of. Mike, anything on yours relate to the Q2 of last year compares the only real driver [that you see]?

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

Yes, I'll just add (inaudible). We are year-to-date where we expected to be, and I think things are going well with sales ramp and driving ARR.

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

And it's early days, as we said, Rishi. I mean we didn't expect to start seeing a real impact in revenue on all of these sales investments and the reallocation that Mike spoke to earlier, [these heads] and so forth until late this year or early next. And so they're ramping. They're getting to that point we're going to start getting full quota out of them versus a ramping quota. But that then bookings, and then we have to wait for that bookings start to actually materialize and turning into revenue. And so I think you'll see more of the positive impact of these investments we've been making since Q3, Q4 of last year in Q4 this year and more so in early part of next year in the revenue side.

Rishi Nitya Jaluria - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

Got it. That's helpful. And then I just wanted to turn to APIs. I believe in your prepared remarks you mentioned 1 of the -- of your customers chose you because of the APIs. So maybe if you could give an example of how customers are using the Blackbaud APIs to maybe change their business or go through a digital transformation or become more efficient or whatever and then maybe how you think that API story kind of can trend from here?

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

Sure. In that case, I talked about school, I believe. And it really is just a function of going with our cloud platform for the school, which covers most of the business functions that the school have but not all. So there are and will always be ancillary sort of pocket solutions that our platforms need to share data with. And we have gone down a path the last several years of open restful APIs, which are industry standard. And it just helps the school basically in that case eliminate a lot of legacy systems by going with our cloud but also to be able to integrate with things that we don't provide, which is usually the departmental solution. That's an ancillary solution. And the fact that we have open APIs, it allows them to go ahead and replace their legacy platforms and then integrate with some of the niche solutions that they need to run a department.

Operator

We will now move on to our next question from Mr. James Rutherford of Stephens, Inc.

James Paul Rutherford - *Stephens Inc., Research Division - Research Analyst*

Mike, just first 1 for you. Can you comment on the level of interest you're starting to see for your new Church Management product as you get ready to take that particular application into general availability? And just help frame of how big or important this product might be for your total business over the coming 6 to 12, 18 months.

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

Sure. A couple of things. First of all, the level of interest is significant. We haven't really shown up in that market as far as conferences and direct drive marketing like we have in the last year. We launched this product at an industry conference, I think, back in the fall now. So the interest has been significant. We've had lots and lots of prospects coming here to talk to us. We've really ramped up the sales headcount in the last 18 months in that team. There has not been a lot of innovation in that space for a really long, lot of legacy systems. So there's a ton of interest. The really interesting thing, too, is that because we're selling an integrated cloud, which is fundraising financials, Church Management, customers are signing up, in many cases, for the whole thing and then going live on financials or fundraising, which is available, of course, now. But there's a pretty decent backlog of customers we've signed up for the new Church Management who are just waiting for general availability. We've got quite a few customers using the system today as Early Adopters. And also, it's a huge market. There's over 300,000 churches in the United States. And if you look at total giving, which is over $400 billion annually, the faith-based market is over 1/3 of that. So it's a huge market that I believe has been very underserved. And it's going to take a while, right, to get realized reoccurring revenue because we're building a new platform that'll be announced in general availability in the next couple of months. So quota attainments really ramping up takes a while for revenue to ramp up in a reoccurring revenue world. But this is an investment for the very long term, and I think it can be a significant growth factor and significant part of our future growth. And no one is doing what we're doing. And it's difficult to do what we're doing because we're bringing our whole product portfolio to the market and building a new Church Management platform for this market. It really hasn't been done this way.

James Paul Rutherford - *Stephens Inc., Research Division - Research Analyst*

Great. That's helpful. I'm not sure if this follows up better for Mike, Tony, but can you update us on the progress of conversion on some of your legacy products to your more modern NXT applications? And perhaps update us where you stand, what you're doing to spur that switch and how long until we're through that conversion. Those are a number of questions in there. But how do you want to comment around the progress on that conversion?

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

Sure. Yes, it's going well. I mean we're a couple of years in now. We knew it was going to take a while to do that. We're not forcing folks to move. Part of it is the product capabilities have not fully done for everybody to be able to move. There's a lot of nichey things over the years that customers have done to build on things based on customer type around Raiser's Edge NXT, for example, that those gaps need to be closed, and we keep closing those every quarter. So it's gone well. A lot of the customers have moved over both in Financial Edge and Raiser's Edge NXT, positive success stories. There's been white papers written up on the impact these products have had with our customer base. It's built with our modern SKY cloud platform, which means it's mobile first, intuitive and features a release every month. So it's a free high-velocity platform. So yes, it's going well. It's still going to take some more time to sort of get that done fully for those 2 products, but we are where we expected to be when we launched a couple of years ago. And there's a few years left. And those products are also in that mix Tony talked about earlier where we've got some of the legacy products still in the COLOs, and we're deploying the NXT products more and more in Azure with our Microsoft partnership. And that -- there's been a pretty big shift from COLO to Azure with, for example, Raiser's Edge NXT on the infrastructure side. So all of that's going well.

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

And James, this is Tony. I think the other thing to note is that it's a tougher compare now because we've kind of -- as we spoke about last year, we've kind of crossed over the top of the bell curve as far as the number of those customers that have migrated, and so that compare is getting harder from a financial perspective. Those first years was more of a pickup on the revenue front because of the uplift we're getting and the number that we're moving over. And now we're past that. So it's a little tougher compare we happen to stomach on the revenue front, but we're -- been able to handle that pretty well now.

Operator

We will now move on to our next question from Kirk Materne of Evercore ISI.

Stewart Kirk Materne - *Evercore ISI Institutional Equities, Research Division - Senior MD*

Mike, I was wondering if you could just comment on sort of your thoughts around M&A given you're bringing on all the sales headcount right now. Is it -- can you kind of do both at the same time, i.e., it seems like you have a pretty wide and broad product portfolio at this point in time. So I'm just trying to get a sense on how you think about that. I think you guys have always done sort of you added in some products as we've gone along inorganically. But just wondering if that might -- if the thought process might shift a little bit given the amount of investment in sales these days and trying to get that squared away first.

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

Yes. Sure. We've actually been doing both the last several years. Our sales headcount ramp isn't a new story, right? Last year, we ramped up 84 heads. That was about double the rate, but the rate has been pretty high the last several years, and we've made some acquisitions. The acquisitions aren't really just about growth. It's really about broadening our TAM and the verticals. We've gone in the last 5 years from really providing fundraising and financials to having a pretty broad portfolio. If you just look at education, our platforms now run the whole school. And in K-12 and higher ed, those expansions came from M&A, but those expansions also make our traditional fundraising and financial platforms stickier and more relevant because we're integrated with the platform, a full-school platform. Same thing is happening in faith-based. So I wouldn't say that we're not going to do acquisitions. It's just going to be opportunistic if we think we can become stronger at a particular vertical and be more relevant in a vertical and move beyond being just a departmental player in fundraising. It's really impactful for K-12 schools or universities now or churches to be able to replace 15 or 18 small vendors with 1 cloud that covers their entire operation and most of their IT spend. So our ASPs are a lot higher. We sell more modules. The footprint creates a bigger opportunity to cross sell. So I'll tell you the answer is it depends. I think we've demonstrated that we can do both, and so we don't have to initially work in serial. We can do some of these things in parallel. And also, they're all quite different. If you look at YourCause, YourCause, that platform didn't really step on top of any other engineering efforts per se that we're doing because it's a different category. And yet we're replacing a legacy product we have in the space with 1 of the largest players on the space, YourCause. So we continue to look. Our balance sheet allows us to do that quite well. And the model has been pretty transparent and straightforward for us. We used bank debt. We paid down. We delever and don't extend too much. I think we ended the quarter at 2.7x. And that will continue to come down. So it really is about fulfilling the strategy in being able to drive organic growth and provide better solutions for our customers.

Stewart Kirk Materne - *Evercore ISI Institutional Equities, Research Division - Senior MD*

That's helpful. And then maybe just 1 follow-up on the Church Management product. When you guys look at the market, how much of the market is sort of just greenfield, meaning people are using either Excel spreadsheets or maybe not even a sort of a traditional server-enterprise software product versus replacement? I'm just trying to get a sense on how much are you a little dependent upon sort of replacement cycles versus -- there's just sort of this wide-open market that folks might not be using sort of any technology at this point in time?

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

Sure. It's a mix. We have seen custom builds out there. We've seen sort of commercial systems cobbled together. And then there's a handful of vertical software companies out there that are predominantly have point solutions. We're doing something unique in the market. Again, we have many churches that signed up that are able to replace 12, 15 stand-alone vendors with a single cloud solution.

The other thing that's interesting is a lot of these institutions have hundreds of K-12 schools as well. And so there's an opportunity with our K-12 platform in addition to -- which is also a consolidation opportunity for them, in addition to our Church Management platform.

And lastly, I'll just reiterate what I said earlier. It's a huge market, big, big market. On the donation side, it's north of $130 billion roughly and several hundred thousand churches of all sizes. So we think it's a really interesting opportunity in the long run. And yes, we're going to do this right. We don't have to go fast. The Church Management platform build-out is going really well. We've got Early Adopter customers on there. We'll be announce the general availability in the next couple of months. And this is a long-run investment that I think will really start to materialize in the coming years, including next year.

Operator

We will now move on to our next question from Mr. Ryan MacDonald of Needham.

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

I guess, wanted to start on the corporate social responsibility market. Obviously, it sounds like you're getting more aggressive with the sales headcount investments with YourCause. We're also seeing sort of Salesforce.org enter aggressively with their Philanthropy Cloud through a reseller agreement with United Way. So it seems like there's a lot of demand in that space. So I guess, I'd just like to know, what are you seeing in terms of sort of pipeline velocity in that area from potential customers? And then, how do you sort of size the opportunity for your costs versus, say, some of the other initiatives in education management and Church Management?

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

Sure. There -- this is a different market, but there's a trend happening that's been going on for a while, which is for companies of all types to be more focused on working with their employees around matching gifts and volunteer time and really tying that to their brand. And these are companies of all types. I think in the last earnings call, I mentioned we closed DuPont. And in my prepared remarks this morning, I mentioned NHL Foundation and Philadelphia 76ers. And it really just to demonstrate that the market is really wide. It's any company of most size, any size, that wants to focus on working with their employees to volunteer and provide matching gifts. That also applies to many of our existing customers. You think about universities and health care institutions that have thousands of employees. So this is a cross-sell opportunity back into our base as well. So I think the opportunity is big.

The United Way side is a little bit of a different thing. Most companies are opting to have platforms like YourCause because employees want to make personal decisions on where they volunteer and where they want to give. We also have United Way as customers. In fact, we recently closed the deal at United Way. I think I mentioned that in the last quarter as well. But YourCause is a different thing. It's a big platform. I think it's a really big marketplace. We are significantly adding sales headcount and the supporting functions there, too, engineering and sales engineers. And I think that's a really interesting market that more and more companies are focused on. They have a good platform today with a big reach. I think I mentioned in previous calls, they have over 8 million employees on the platform, and over 120,000 nonprofits have received donations through the YourCause platform over the last several years. So there's also an interesting opportunity for us with those institutions given the rest of our product portfolio. So I think this is a big and interesting market and a growing market. There's only a couple of players in this space.

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

Got it. And then just a quick follow-up for Tony. I guess as we're looking into the back half of the year here and sort of expectations for the JustGiving business, obviously, with it being a U.K.-based entity, that gives you some increased exposure there as we sort of move towards a Brexit decision at the end of October. Does that -- what sort of expectations, I guess, are you building in, in terms of FX or impact on sort of that overall market there?

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

Yes. FX is a wildcard, right? I wish I could predict it. We had some impact in the first half from currency fluctuations, largely driven by the U.K. market. I think it impacted us by about 1 point of growth on revenue into the negative. So we'll just have to keep an eye on that one. Who knows what's going to happen with all the changes there recently and with Brexit. Market has been off there. I think part of the reason that U.K. market off -- is off and has been is some of the same things, Brexit concerns and their related economic concerns. There's been a decline in major onetime events there versus prior years, and I think just overall giving has been -- environment has been pushed down in the U.K. because of a lot of different factors. So we'll just have to keep an eye on. There's no way I can predict what that will be.

Our core business, that means, JustGiving is just a piece of our U.K. business, our core business of selling our product portfolio is actually doing really well. David Benjamin has been onboard now and got his feet well underneath him, and we're doing a really great job. I think the work that he and the team are doing with Canada, which is another currency we have to deal with, we're ramping really well in Canada. I'm excited about what we're doing there with David and the team. So I feel good about the international overall. The giving side of the U.K. market is something we'll just have to keep an eye on and see how that affects us.

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

Yes, we've done a great job with leadership recruiting in our international business. Sales headcount ramp-up is underway, has been there as well. And we think there's a big opportunity. Their sales execution has gone well in our international business.

Operator

We will move on to our next question from Mr. Mark Schappel of Benchmark.

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

Mike, with respect to the new faith-based solution, could you go into a little bit more detail what you believe are some of the differentiators of your solution? And also, with respect to that solution, maybe just give us a few details on some of the early pilots that you're currently conducting and what you're seeing, what some of the feedback has been?

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

Sure. So the differentiator is a single cloud platform for these institutions. As I mentioned earlier, in most cases, they have an opportunity to replace 12, 15 software products from 12 to 15 vendors. So you think about operating an institution where you have to log in to 12 different user experiences. Each of those platforms probably have very lightweight or any integration. All 12 of those platforms have different reporting engines, and you can't aggregate data unless you build a separate reporting engine that aggregates data. And these institutions don't have an IT shop that can do that. So with us, there's 1 log on to run the whole business, if you will, all integrated. So you can do things like create a dashboard report and connect the data points across the institution, pretty unique. So you have 1 vendor with a road map that has a significant investment in the platform, and it's a modern, mobile, intuitive platform. And it includes all the components of running a church, facilities to daycare, the financials, fundraising in an integrated platform as opposed to signing up with 12 or 15 different vendors. I mean it's completely different platform, and it's a modern platform, and it's stable and scalable. And some of these smaller vendors are a handful of employees. So there's a massive difference in what we've done and what the experience has been with the Early Adopters. We have many, many clients who signed contracts here and are in the backlog. They go live, and we've got quite a few live. And in Early Adopter platform, we just been using the system every day, providing our engineering team with feedback. And like I said, we'll announce general availability in a couple of months.

Operator

It appears there are no further questions at this time. I'd like to turn the conference back to Mr. Mike Gianoni for any additional or closing remarks.

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

Thanks, operator. I'll just close the call by saying I'm pleased with our execution through the second quarter and year-to-date '19. Our aim is to deliver a digital transformation across the social good community in all the markets we serve. I'm really excited about our progress across the board with the advancement of Church Management platform, our higher ed platform and the addition of YourCause. All these represent significant growth opportunities for us for a long time. These investments will ultimately create lasting value for our customers, employees and shareholders. Tony and I look forward to updating you guys on our progress call -- on our progress in the next call. Thank you, everyone. Have a good day.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.
