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Q4 2023 Blackbaud Inc Earnings Call

EVENT DATE/TIME: FEBRUARY 13, 2024 / 1:00PM GMT

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PRESENTATION

Operator

Good day, and welcome to Blackbaud's Q4 Full-Year 2023 Earnings Call. Today's conference is being recorded. I'll now turn the conference over to Kevin Mooney. Please go ahead, sir.

Kevin W. Mooney ***Blackbaud, Inc. - Executive VP of Strategy & Business Development***

Good morning, everyone. Thank you for joining us on Blackbaud's Fourth Quarter and Full-Year 2023 Earnings Call. Joining me on the call today are Mike Gianoni, Blackbaud's CEO, President and Vice Chairman; and Tony Boor, Blackbaud's Executive Vice President and CFO.

Mike and Tony will make prepared comments, and then we'll open up the line up for your questions. Please note that our comments today contain certain 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. The discussion today will focus on non-GAAP results.

Please refer to our press release and the investor materials posted to our website for the full details on our financial performance, including GAAP results as well as full year guidance. 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 substitute for GAAP measures.

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

Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Thank you, Kevin. Thank you, everyone, for joining our call today. I'd like to start today's comments by offering a few perspectives on 2023, then I'll comment on our product evolution, share a few customer wins and then conclude with an update on our capital allocation and stock repurchase plans before turning the call over to Tony.

The fourth quarter concluded a year of substantial transformation for Blackbaud. Approximately 1.5 years ago, we implemented our 5-point operating plan, which began producing results in the second quarter of last year, continued through year-end and has put our company on a clear trajectory of improving financial performance. In the second quarter, our cost management initiatives drove significant adjusted EBITDA margin expansion as expenses declined year-over-year. Then in the third quarter, our revenue growth rate accelerated as our modernized pricing program gained traction, and we achieved the Rule of 40 ahead of plan.

And today, I'm pleased to report that our company's adjusted free cash flow grew substantially and enabled the company to begin returning cash to shareholders in the form of an active stock repurchase program. So 2023 has been a transformational year for the company. To put that transformation into perspective, we entered the year in our social sector with only about 1/3 of opportunities renewing on multiyear contracts, and we exited the year with 3 quarters of opportunities renewing on multiyear contracts. We entered

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the year with none of our customers on our modernized contract pricing, and we exited the year with approximately 35% of our eligible customers on modernized contract pricing.

We entered the year with organic revenue growth of less than 1%, and we exited the year with fourth quarter organic revenue growth of over 7%. We entered the year with EBITDA margins of under 25%, and we exited the year with fourth quarter adjusted EBITDA margins of over 33%. And we entered the year with a Rule of 40 score of 25, and we exited the year with a fourth quarter Rule of 40 score of 41. That's transformational performance. I'm pleased with the results the team has produced. I'm excited about the continued momentum we expect in 2024, as you'll hear today.

For the full year 2023, Blackbaud produced revenue of $1,105 million, adjusted EBITDA of $356 million, non-GAAP diluted earnings per share of $3.98, adjusted free cash flow of $214 million, and a Rule of 40 score of 37%. All of these measures are substantially better than 2022's performance and meet or exceed the increased guidance ranges we released in Q1 of 2023. Tony will share greater detail on our financial results in his comments.

Now turning to product. During the fourth quarter, we continued to focus on delivering more value to our customers through product innovation. For example, we increased the power of social impact based fundraising with the announcement of an early adopter program for new optimized online giving capabilities. These new capabilities enable native integration with products across Blackbaud's portfolio, and in early testing are raising considerably more funds for our customers. It will be generally available for U.S. Raiser's Edge NXT users this week, with availability coming soon for Blackbaud CRM and all true customers.

Also in the fourth quarter, we announced the availability of our Good Move mobile application for all TeamRaiser and peer to peer events. This enables a streamlined experience for participants while expanding participation to virtual as well as in-person events. And as part of Blackbaud's intelligence for good strategy, our investment in artificial intelligence, continued with the launch of Prospect Insights Pro, an intuitive guided experience to deliver AI-driven insights in support of planned and major gift fundraising.

So plenty of progress on the product innovation front. Customers are utilizing this technology to further their mission and improve their operations, and this is shown by our wins from this last quarter. For example, American Parkinson's Disease Association selected Blackbaud to consolidate its direct marketing and CRM functions from multiple vendor solutions. The Blackbaud unified solution, which includes partner capabilities, will help APDA continue to surpass their fundraising goals and support their mission to help everyone living with Parkinson's disease to live life to the fullest.

Also during the fourth quarter, The Salvation Army Western territory sought to modernize and improve -- manages consistent data to increase fundraising and enhance engagement. The organization chose Blackbaud's BBCRM over 2 very large competitors owing to our singular focus on nonprofits.

And the Rockford Christian School in Illinois purchased our total school solution. The school is driven by a strong desire to better inform business decisions as well as optimize the parent, student and teacher experience as it plans for growth over the next 5 years. This competitive win replaced several disparate legacy systems and includes a comprehensive suite of student enrollment, student information, tuition management and financial management.

On the corporate impact side of the business, News Corp selected YourCause to power their corporate giving and volunteering programs in the communities they serve across the globe. And Fidelity Investments expanded its collaboration with EVERFI by sponsoring a new high school financial education program, featuring a first of its kind investing simulation, aligned to Fidelity's commitment to financial literacy and providing the next generation with access to meaningful financial education.

So in summation, we're bringing mission-critical solutions to our customers that we're continually involving to have greater impact and value. Our customers recognize the value of our solutions as shown by the increase in multiyear contract renewals and the adoption of our modernized contract pricing.

Now I'd like to provide an update on our expanded stock repurchase program. This is an important development in our transformation

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and is predicated on our strong and growing cash generation. On January 22, we disclosed that in December and January of this year, we're actively buying shares in the open market, investing approximately $41 million to acquire almost 500,000 shares. Given the upside we see in the business and continued strong performance expected in 2024, we believe these repurchases are a good investment for our shareholders.

We also announced that our Board increased our go-forward, repurchased authorization to $500 million, doubling the previous $250 million authorization. That gives us a lot of headroom for future stock repurchases. At a minimum, we plan to buy back the dilution from an annual stock-based compensation.

Historically, we have taken an opportunistic approach to capital allocation, and we expect that to continue. Value-creating M&A will also remain a capital allocation priority to the extent that investments and acquisitions are available that strengthen our business, enable growth and create shareholder value, we will deploy cash to do so. Of course, such opportunities are hard to predict. We remain focused on making prudent investments to grow the business, both organically and inorganically, while returning excess capital to shareholders.

So the books closed on what was an outstanding year for Blackbaud. Let me turn the call over to Tony, who will share more details on the financials and why we're enthusiastic about 2024. Tony?

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

Thank you, Mike, and thank you all for attending our call today. I'll start my comments today with our fourth quarter financial results and what's driving the significant improvement the company has been delivering. Then I'll briefly cover the full year 2023 before turning to our financial guidance for '24, and conclude with a discussion of our capital allocation strategy.

Turning first to our fourth quarter financial results. We had another quarter of improving performance. Results for the quarter were strong and demonstrate the impact of our 5-point operating plan is having on the business. Specifically, our modernized pricing initiatives continued to produce price increases at renewal, gross dollar retention rates were within the range of expectation and transactional revenues were seasonally strong from both a giving and pricing perspective.

As a result, contractual recurring revenues grew 6.4%, transactional recurring revenues grew 12.5% and total recurring revenue grew 8.4%. Nonstrategic onetime revenues declined by $2 million and represented about 1-point of drag on total revenue growth.

For the quarter, total revenues reached $295 million, which was an organic growth rate of 7.4%. That's the fourth consecutive quarter of posting an increased growth rate.

Cost management has been a key focus. The cost actions we've taken from head count reductions to data center closings, vendor renegotiation and virtual workforce environment, all contributed to an expense base that was lower than last year. With $20 million of revenue growth and $11 million of cost reductions, our adjusted EBITDA grew by $31 million or 46% to $99 million for the quarter. That's excellent flow-through and leverage.

In terms of the margin, the adjusted EBITDA margin of 33.6% was almost 9 percentage points higher than Q4 of last year. Earnings per share was $1.14 in the quarter, and the business produced a Rule of 40 score of 41%, so really solid performance.

The full year financials tell much the same story of improving top line growth, coupled with cost-cutting measures, which dramatically improved profitability and cash flow. A year ago, when we offered initial financial guidance, I said that in 2023, we expect financial performance to improve with each successive quarter, starting with meaningful improvement in the second quarter. And that all held true.

We met or exceeded our financial guidance ranges across all metrics for '23. Full year revenues were up 4.8% on an organic basis to $1,105 million. Adjusted EBITDA of $356 million was up $94 million or 36% and was evenly distributed between revenue growth of $47 million and cost reductions of $47 million.

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Our ability to lower cost while growing revenue speaks to the power of our 5-point operating plan. Earnings per share increased to $3.98 compared to $2.69 last year. Adjusted free cash flow came in at $214 million, up from $154 million last year, representing an adjusted free cash flow margin of 19.3%. And as Mike noted, this strong cash flow enabled us to return capital to shareholders through the repurchase of almost 500,000 shares through January.

Now let's spend a few minutes on our financial guidance for '24. To set the table, we foresee a continuation of what we started 1.5 years ago with our 5-point operating plan, driving improvement across the business. We're continuing to invest in our products and expect to continue delivering capabilities that our customers value. Our modernized approach to renewal pricing and contract terms is well established and will be managed closely.

We have a proven track record of tight cost management, and will drive the business to maximize profitable growth and cash generation.

Starting with revenue. We see revenue in the range of $1,170 million to $1,200 million. At the midpoint, our organic revenue growth will expand to 7.2%, up from 4.8% last year, an increase of 240 basis points.

Importantly, we believe the decline in nonstrategic onetime revenues will slow in '24 compared to the last few years with a drag to total organic revenue growth of about 0.005%. We've assumed a relatively stable foreign exchange rate environment for guidance purposes.

Shifting to profitability. We will keep tight hold on costs and maintain head count close to our current levels realizing there will be quarter-to-quarter fluctuations with the timing of attrition and hiring. And at the same time, we're making investments in the business in areas of innovation, artificial intelligence, product road maps and cybersecurity.

Accordingly, we're guiding that costs will grow at a slower rate than revenues. And as a result, adjusted EBITDA margin is expected to be in the range of 32.5% to 33.5% with a midpoint of 33%. The combination of higher growth and better margin is expected to result in a Rule of 40 score of 40.2% at the midpoint of guidance for the full year, a more than 3-point improvement year-over-year.

Also recall that our business has a degree of seasonality, with the second and fourth quarters typically outperforming in the first and third quarters. Earnings per share is expected to be between $4.12 and $4.38, with a midpoint of $4.25. We factored into our projection a higher non-GAAP annualized effective income tax rate of 24.5%, a 450-basis point increase from the 20% rate used in 2023. The increase reflects greater profitability in the business as well as an increase in U.K. corporate tax rate.

Additionally, we have a sharp focus on driving adjusted free cash flow and returning capital to our shareholders. For the year, we're guiding to adjusted free cash flow of $254 million to $274 million. The $264 million midpoint represents a 22.3% adjusted free cash flow margin and a significant improvement of 300 basis points over 2023, despite approximately $30 million in additional cash taxes expected this year, and additional investments in product and cybersecurity.

Our last but certainly not least, a few thoughts on capital allocation. This past year, we turned the quarter, and for the first time ever, generated more than $200 million of adjusted free cash flow. This enabled us to make approximately $50 million in security incident settlement payments, repurchased approximately $19 million in shares in December, while at the same time, reducing our debt to adjusted EBITDA ratio to approximately 2x.

Looking to the future, the company believes adjusted free cash flow will continue to grow and anticipates offsetting dilution from share-based compensation. Beyond that, the company has tremendous optionality to dynamically allocate capital to its highest use based on market conditions, including synergistic M&A, additional stock repurchases or repayment of debt. The availability of acquisitions, the performance of our share price and the interest rate environment will help inform our capital allocation decisions.

Before we open the lines for your questions, let me summarize. The fourth quarter demonstrated continued progress against our 5-point operating plan that has transformed our financial results. This past year, the company accelerated revenue growth, reduced costs, expanded profitability and started returning capital to shareholders.

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We have a plan for 2024 that we expect will continue those trends, improve financial performance will continue enhancing value for our shareholders.

With that, we can open up line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Rob Oliver with Baird.

Robert Cooney Oliver ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Mike, I had one for you and then, Tony, a follow-up for you.

So Mike, as we enter year 2 of the sort of a new price optimization regime for you, guys, it appears to be going quite well. And I was just curious if you could share your thoughts relative to as we get into kind of the second half of this renewal motion on pricing, how you guys are thinking about the contribution of price to the top line relative to other things like cross-sell, upsell, new product sales? I know you knew -- you cited some wins for EVERFI.

Just want to get a sense for how should we -- should think about expansions and new customers in addition to just price? And then kind of a follow-up for Tony.

Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Yes. Sure, Rob. Thanks for the question. The program is going really well. It kicked off a while ago, but went live March last year, and the volume grew as we got through the year and got through about 35% last year of the total. Retention rates are up because most folks are taking the 3-year contract options. So we're basically moving the company from historically 1- to 3-year contracts, which is really great for retention go forward.

And so we're in the second year and we'll renew about 30% more roughly this year, coming out of the year at about 65% of the total at the end of this year. So it's a multiyear program, going really well, focused a lot on innovation because we need to keep earning our clients' rights to sign 3-year contracts with new products. And I talked a little bit about that in my prepared remarks.

Sales bookings, going pretty well. We closed the year fairly strong. We had a good start to the year. Pipeline is good. The corporate impact sector, I mentioned a couple of clients that we closed. I'd say that's a little bit softer than the rest of the business. But lots of interest there, too. We don't see anybody really pulling back on investments there.

I don't know if you noticed it, but the NFL chose to run 2 ads during the Super Bowl on what's called the Character Playbook that runs on our EVERFI platform. And as you might guess, we're getting a lot of interesting inbounds from that.

So all in all, we had a really good year last year. And coming in at 4.8% growth is the highest in, what, 6 years in our organic growth. And then a guide at midpoint of 7.2% up to 8.6% on the high end. I think we're set up really well for '24 also.

Robert Cooney Oliver ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Great. Appreciate that.

And then Tony, just a question on the EBITDA margins. Just what some of the priorities for you as sources of spend are for this year? You guys continue to do a really strong job on the margin side. It was a little bit below what we thought you guys were going to do for '24, but still solid. So I just wanted to get a sense for kind of where perhaps that spending or divergence between that and our thoughts relative to what you guys are going to be spending on, what that might be?

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

Yes, Rob, thanks for that question. EBITDA margins have improved dramatically. As we've seen, we finished the year really strong, did great last year. '24, we're currently expecting that we'll manage the business for the year somewhere close to the same head count where we ended, which is down about 600, I think, from our high or our peak. So we're kind of planning on running the business in that same head count. Obviously, you're going to have some merit increase and cost of living increases, those kind of things that we have to deal with, even with that lower headcount.

The biggest thing really Mike alluded to it, and we talked about it a little bit in the prepared comments, we've got a bit of incremental investment in innovation on the R&D side of the business, some security, cybersecurity-related investments as well that are driving a little bit of incremental costs.

Overall, costs are still growing slower than revenue, which is a key focus for us. But this year, with the couple of those incremental investments, we're not seeing quite as much leverage on the EBITDA front as we'd expect going forward longer term.

Operator

Our next question comes from the line of Brian Peterson with Raymond James.

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

So I wanted to follow up on some of the pricing initiatives. Obviously, that's gone pretty well. It looks like you have 30% of the base coming up for renewal in 2024. Any lessons learned in 2023 that helps you attack that?

And then how should we think about anything in that base in terms of timing or customer exposure or products that we should be paying attention to?

Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Yes. I think we learned a lot last year. We didn't really need to make many adjustments though. I think we just got better at communicating. We notify customers 5 months ahead, right? So we're already out almost in June of this year now. So we saw retention rates go up. Most customers are signing for the 3-year contract. We've got our heads down on just driving more innovation because we feel like we need to continue to earn the right to have a price increase and have 3-year contracts. So we're really focused on a lot of innovation. Tony just mentioned that.

But program is going really well. We did -- like I said, we did 35% of the base last year starting in March. We'll do another 30% this year. And so we're starting to get sort of full year effect this year of last year's, and then partial year effect of this year's this year, because most of the larger volumes are sort of June, July and then toward the fourth quarter. So it takes kind of a next year to really pick up on that uptick in volume. But program is going really well. It's good to see retention rates increase with this program.

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

That's good to hear. And maybe a follow-up to Rob's question on the net new side. It sounds like the pipeline and some of the opportunities you mentioned there are pretty strong. I'm curious, how is the pricing and kind of the multiyear contract looking on the net new side? And anything that's changed competitively that you're seeing out there in the market?

Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Yes. We moved our list prices up a bit as well on some of the products, we haven't done that in a while. And we're faring pretty well there. We've made a tweak in our sales comp plan to drive more units. So we're focused on units. That's new logo and cross-sell. We still have our teams focused in that way in the vertical markets that we're in. So they're -- like historically, they're signed by vertical market and assigned to cross-sell to existing or go get new logos. That hasn't changed, but we made a tweak to the plan to just keep focusing on adding new units across the board. So no major changes there.

Operator

Our next question comes from the line of Parker Lane with Stifel.

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

Yes. Tony, I was wondering if you could talk about leverage a little bit more in the business. If we look at your adjusted EBITDA and free cash flow guide, I know you referenced that you're going to have head count relatively stable at the end of this year relative to where it started. What other opportunities are there to drive efficiencies across the different cost lines of the business?

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

Thanks, Parker. That's a good question. I would expect we will continue to see us gain scale and leverage just from the higher growth rate that we're driving on the top side. It's a lot easier to drive more profitability when you're growing in that high single digits than the low single digits. You eat up most of that lower growth improvement and profitability just in the normal merit and other increases that we see year-on-year. So as we grow faster, it will certainly be easier to scale and gain leverage in the business, and be able to hold our head count.

Our investments are going to be up a bit this year, that's why we're not seeing quite as much leverage. Some of that's kind of onetime in nature. We're accelerating some of the investments on the cyber front to get some things completed a little bit more quickly than what was originally planned. And so that's pulled a little bit of an expense into the year.

And then we're putting a good chunk of money into AI and innovation. We talked a lot about at bbcon, we've had quite a few press releases, there's a lot of good news on the innovation front coming as well.

So I think we're up a little bit higher than what we would typically expect to be this year on some of the spend, hence not seen as much leverage. But I would think going forward, you'd see us continue to generate additional leverage in the business year on -- year-on-year.

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

Got it. Very helpful. And then, Mike, on the corporate impact space, I think you mentioned that was a little bit softer but didn't necessarily see people pulling back. Can you go into the dynamics of that market, in particular at a little bit deeper? And how do you feel about the structure of the team you've got centered around the corporate opportunity right now?

Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Yes, sure. Tom Davidson heads up that corporate impact team for us. He is the CEO and founder of EVERFI. And so we combine that with a few other products, they have 5 products now they take to that corporate market, which is great because there's cross-sell opportunities there. So it's a solid team.

The market is a very large market. What's interesting about that side of the business is there's optionality for contracts substantially larger than the historic Blackbaud cloud software side. Some of these contracts can be several million a year in ARR because they're big companies and big footprint. And we've got an amazing presence in that market. I mentioned the NFL decided to run 2 ads during the Super Bowl on a platform that's built on EVERFI, which is amazing.

And there's many Fortune 500 companies that are our customers or prospective customers. We put together a partnership with Fortune a little over a year ago. They started a whole focus around this corporate impact space, and we were a founding partner with them and I have met with several hundred Fortune 500 global heads of Corporate Social Responsibility.

So EVERFI definitely punches above its weight, if you will, as far as presence. I haven't met a customer that wasn't enamored with EVERFI. Now the downside is, it is a discretionary spend. And so the programs are subject to that occasionally. But it's a solid platform with an unbelievable brand and a lot of really interesting relationships.

So that market is not really pulling back. The company is -- there's a lot in the news about CSR and ESG programs and things like that. But if you look at just -- I'll give you an example, in the financial services space, banking in the U.S., the government requires those institutions to invest in the space. So there's a regulation that requires a give back. In a lot of cases, they're choosing YourCause or EVERFI as that platform. So that's a regulated requirement, which is great for us. It is the biggest space that we're in financial services.

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So it's a big space, global customers, really solid team. I think we've got great opportunities. I mentioned -- what I mentioned, News Corp and Fidelity in my prepared remarks, 2 recent larger expansions.

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

Got it. Very interesting. Congrats on the quarter.

Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Yes. Thank you.

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

Thanks Parker.

Operator

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

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

Maybe just following up on the last question, Tony. In the slide deck, it calls out that there's still 2 more data centers to wind down.

Curious on a go-forward basis from here, given you've gotten through most of the DCs you're operating, how much benefit from here is true cost reduction as your favorable contracts with Azure and AWS roll through versus sort of offsetting future spending of continuing CapEx and reinvesting in those data centers? How should we think about that sort of impacting gross margins long term?

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

Yes, Matt, the CapEx, as you know, has been dropping off substantially as we've shut down the data centers and moved to the cloud. There is continuation of that same story this year.

As you saw in the earnings release on the guide, CapEx is going to be down. Cap software is relatively stable and growing, with all the spend that we're putting on innovation. So we'll see that up a little bit. But CapEx itself, through CapEx buying property and equipment, will be down substantially.

We're still spending money to move data centers. So we've got some duplicative costs because we've got the cost of the cloud environments and the existing data centers and the cost to move and migrate. And there's still some engineering work that's being done as well to prepare the products to move to the cloud out of the existing infrastructure.

So there's still some duplicative costs that go away on that front. And then I do think we'll be more efficient in the cloud over the long run, certainly, when you incorporate all the benefits of additional cyber opportunities within the cloud environments.

And so we'll continue to see some improvements there. We've still got some leases. We inherited a pretty big operating lease on the facility for EVERFI that we're still working to sublease and get out from under. So we still got some of those costs, which we would hope would go away. So there are a few of those kind of big movers.

And then we're starting to look at use of AI internally as a company. We still have a lot of automation opportunities within the business. So we still have other areas that we're pursuing that should drive some fairly substantial, I'd say, cost savings overall over the next few years. And then I think just leverage again, as we spoke about earlier, from the business, growing faster will certainly make it easier to gain scale.

So we would expect that we've got some opportunity on the profitability side going forward. And the nice thing is we're already up, as you've seen at the midpoint of guide, above at 22% adjusted free cash flow margin guide, which is tremendous. I think we were down in the 14% range in '22, and jumped up to 19% last year and 22% for this coming year, which is just tremendous. And I think that we would

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expect to see that improve kind of in line with profitability improving.

The only area that we've had that's taken us backwards is just our expectation of cash taxes. And that improvement to the 22.3% at the midpoint includes about $30 million of incremental cash taxes because our -- as you saw, our book rate we're using is going up to 24.5%. I spoke about that a bit in my prepared comments from 20%. And that's largely because we've got a great profitable business in the U.K. and the statutory rates there went from 19% to 25% last year. So we'll have a full year impact of those.

And then we're just getting closer to the statutory rate for the U.S. Our federal is about 21%, and state, I think, is roughly 5%. And so we're getting close to the statutory rate in the U.S. as well, largely because our credits are relatively fixed and our income is going up so fast.

So we'll have a little higher cash tax rate for book and cash taxes that's hit in a bit on the free cash flow that's built into that improved number as well, which is great.

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

All right. Very helpful. And then I guess, Mike, when you're looking at kind of the emphasis on new units, as you mentioned, trying to drive some new business there. Where do you feel like you stand from a sales capacity standpoint versus improving productivity and execution of the current reps, any ideas around head count growth? Or do you feel like you have the right team in place and it's just about driving the right performance?

Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Yes. I think we have the right team in place and the right leadership in place, too. We've hired some outside leaders in the last 6 months or so to lead up some of our teams. So we don't see a substantial increase in the head count. We do see significant opportunity, though, in productivity or quota attainment by person.

Operator

Our next question comes from the line of Kirk Materne with Evercore ISI.

Peter John Burkly ***Evercore ISI Institutional Equities, Research Division - Research Analyst***

This is Peter Burkly on for Kirk. Congrats on the strong '23.

Tony, I appreciate the color just in terms of some of the incremental investments in specifically areas like AI. Just curious in terms of the timing of those investments. Would you expect those to ramp over the course of the year? Or will the investments be fairly linear? Just trying to get a sense on how you see the shape of the EBITDA margin over the course of the year?

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

Yes, Peter, they will ramp a little bit, although I'd tell you, we accelerated some of those investments beginning in Q4. So they actually already started ramping. That said, I do think we'll see a bit more as we get into the year because some of those include hiring new staff, those that are outside consultants. And then we also have some investments in some new solutions, I think, on the cyber front. So we'll be bringing new software solutions, et cetera, online and implementing.

So I think those costs will hit us a little more as we get into the year. So expect that to build a bit across the year. And then some of those will start falling off as well as we get -- there's a bit of a surge and an acceleration. So as we get some things implemented and put in place, then some of those will start to drop off as well towards the back end of the year.

Peter John Burkly ***Evercore ISI Institutional Equities, Research Division - Research Analyst***

Very helpful. And Mike, maybe just a quick one for you as well.

Just as you're thinking about adding some of those AI capabilities into the product set, would you expect most of this to be included in the new pricing structure? Or do you see an opportunity to sort of leverage AI and create some new stand-alone offerings?

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Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Yes. It's both. Actually, Peter, it's a little bit of both. So some of this new capability will just show up in products. For instance, last year, the first one we announced into production was a new set of AI capability in our JustGiving platform, already in production.

We have new capabilities that are rolling out this week in Raiser's Edge NXT and more coming across other platforms like CRM and Altru, for example.

Some will be stand-alone new capabilities. So we have some online donation capabilities with AI that are additive and new to the market that will go across several products. And then some are embedded like the JustGiving one I just mentioned. So it's a little bit of both.

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

And Peter, I'd just add on some of the new capabilities like with online giving forms, it won't be that you price separately, they will drive more revenue just because of the efficiency of giving that they drive and/or if we have a complete cover type model where we're just getting a higher amount of donation to us and to the -- to our customers. As we've spoken about before, it will be a big win-win on those things with the new donation forms as they roll out.

Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Yes. So some of those capabilities are pointed toward driving our customers' revenue, which also rides on our payment system as well. So it's a win-win.

Operator

And we have reached the end of the question-and-answer session. I'll now turn the call back over to Mike Gianoni for closing comments.

Michael P. Gianoni ***Blackbaud, Inc. - President, CEO & Vice Chairman of the Board***

Thank you. Thank you for joining us this morning.

To summarize, '23 was a year of substantial transformation for Blackbaud. Our 5-point operating plan delivered 4 sequential quarters of accelerating financial performance. And we met or exceeded our financial guidance ranges across all metrics.

Our strong cash generation enabled us to resume stock repurchases in the fourth quarter and going forward. We're focused on making prudent investments to grow the business organically and inorganically while returning excess capital to shareholders.

I'm incredibly proud of the results the team has produced and excited about the continued momentum we expect in 2024. Thank you, everyone.

Operator

And this concludes today's conference, and you may disconnect your lines at this time. Thank you for your participation.

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