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PRESENTATION

Operator

Good day, and welcome to the Blackbaud Second Quarter 2018 Earnings Call -- Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mark Furlong, Director of Investor Relations. Please go ahead, sir.

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

Good morning, everyone. Thanks for joining us on Blackbaud's Second Quarter 2018 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 call 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. Please also note that unless otherwise specified, we will refer to 2018 results and comparable 2017 results as adjusted to reflect our adoption on January 1 of ASC 606 related to revenue from contracts with customers.

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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 the Oppenheimer Technology, Internet & Communications Conference in Boston; Canaccord growth conference in Boston; KeyBanc 20th Annual Growth Technology Leadership Forum in Vail; D.A. Davidson vertical technology conference in New York; and Stifel's 2018 Baltusrol Executive Summit in New Jersey. We will also be holding meetings with investors in New York, Boston, Portland, Seattle, Montréal and Toronto. Please also mark your calendars for our annual Investor Day on October 10, which will be held in Orlando, Florida in conjunction with our user conference, bbcon.

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. We've continued the momentum from Q1, furthering our move toward subscription-based reoccurring revenue model with our non-GAAP organic reoccurring revenue growth accelerating to 8% in Q2 and the mix of reoccurring revenue now comprising 95% of total. The market remains very strong. Charitable giving continues to grow, and the pace of innovation we're delivering to our growing base of over 40,000 customers and millions of individuals is unmatched in our industry.

Giving USA reported that the number of nonprofits increased by roughly 50,000 organizations in 2017, and charitable giving in the United States surpassed $400 billion for the first time in history, with 5% growth and $410 billion in total contributions. And our own index suggests that giving continues to exhibit healthy growth into 2018.

This is a massive global industry and an opportunity for Blackbaud to offer innovative solutions to the millions of institutions around the world, helping them to drive digital transformation to increase effectiveness and have impact on their missions to drive outcomes. As usual, Tony will provide more detail on our financial results, and I'll provide an update in the context of our 4-point growth strategy.

The first of our 4 growth strategies is integrated in open solutions in the cloud. We've made a major announcement this month and a powerful step forward on this front with the introduction of our comprehensive Cloud Solution for Faith Communities. Blackbaud will now bring our proven strength in financial management, fundraising and CRM, marketing, payments and analytics together with completely new church management capabilities. With this move, we will now provide integrated end-to-end cloud capabilities and enable churches to digitally transform their operations through a single, connected experience.

This means churches will finally have a comprehensive modern cloud solution built for the way they work from a single accountable provider, who can help them reduce their IT footprint by 8 or more systems. No one in this industry has taken this approach with the modern cloud platform.

We already have a large customer base in the faith community, including churches. But what's really game-changing is the launch of an integrated cloud solution specifically for this market with a full suite of applications that come pre-integrated, including our entirely new church management capabilities that we built natively using our SKY platform. We're now giving church leaders the ability to track gifts and tithing, simulate new members, directly communicate with their congregations via multichannel communication, enable members to make online and mobile contributions, manage small groups of volunteers, implement secure child check in, conduct background checks, provide bulk tax statements, manage facilities and much more. Churches will also be able to add other Blackbaud capabilities from the new Cloud Solution for Faith Communities as their needs scale all through one integrated experience, which is powered by the Blackbaud SKY platform.

This is a solution offering that we've been evaluating for quite some time, and it's a massive opportunity for Blackbaud to deliver innovation in a market that's predominantly legacy point solution software. We announced the launch of this new cloud solution main stage at the Church Network Annual Conference in New Orleans, and our team of associates were immediately overrun with church leaders energized by the potential of our comprehensive cloud solution to transform the way they manage their operations.

What's really exciting for us is that the development of the Blackbaud Church Management takes full advantage of the rapid innovation, modern user experience and enhanced capabilities made possible by our Blackbaud SKY platform. What that means is our development didn't start from scratch. We sprinted out of the gate by leveraging preexisting capabilities available on Blackbaud SKY, like our Blackbaud ID single sign-on capability,

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our SKY UX user interface component library, our SKY business intelligence reporting capability, our payment services for credit card transaction processing and our SKY engineering system, which provides standardized templates and tools for development and delivery, utilizing our microservices architecture.

And what's really cool is Blackbaud SKY will enable us to continue to rapidly evolve and deliver new innovation natively in our new Blackbaud Church Management solution and more broadly, our entire portfolio of vertically optimized cloud solutions. We have a high-velocity engineering environment, leveraging a mature ecosystem of existing and ever-evolving software services and components. This is a great demonstration of our ability to rapidly build new solutions to further address customer needs and grow our addressable markets.

Customers are signing up for our Early Adopter Program for Blackbaud Cloud Solution for Faith Communities and the Church Management components, which will be available next year for general availability. As faith organizations continue to seek better ways to connect and deepen relationships with their congregations, our Cloud Solution for Faith Communities is designed for church leaders and decision-makers seeking to expand participation and engagement.

James River Church is a great example. This multi-campus church with a weekly attendance of 20,000 congregants conducted an extensive search and chose to partner with Blackbaud to replace 11 different software vendors they were using by purchasing Blackbaud's Cloud Solution for Faith Communities. This all-in-one modern cloud solution includes fundraising, financial management, marketing, analytics, payment services, social engagement and our new Church Management solutions.

I'm going to read a quote from the Chief Operating Officer of James River Church. "As a large multisite church, for several years, we looked at a variety of vendors but never felt we had one that could meet all of our needs and reduce multiple software systems that we were using. And Blackbaud has risen to the top to meet that challenge."

For a church like James River, we enable them to fully manage their day-to-day operations with one integrated cloud solution. We'll be in a position to replace a majority of single-point solutions and vendors of faith-based organization needs today, driving significant improvement and effectiveness and enabling churches to offer a cohesive experience to their members, attendees, staff and volunteers.

This leads me to our second growth strategy, which is to drive sales effectiveness. Selling integrated cloud solutions that are purpose-built for organizations, like our Cloud Solution for K-12 private schools, for example, is a key competitive differentiator for our sales teams.

Our sales account executives now lead with a total solution selling strategy by vertical, focused on reoccurring revenue and driving more products for customer, higher ASPs and increased customer retention over the long term. We know that attaching training, analytics and payments improves the cloud experience, drives customer outcomes, improves retention and increases customer lifetime value. And we continue to innovate and acquire solutions that create value for our customers.

Earlier this month, we released new fundraising benchmarking capabilities in Raiser's Edge NXT that complement the existing set of SKY Reporting tools and leverage Blackbaud's proprietary data, giving our customers the ability to compare their performance and key fundraising metrics against their peers.

This is unique to Blackbaud. These capabilities not only provide customers with performance insight but also quantify the value of improving their performance and refer them to specific tools inside of the Raiser's Edge NXT to drive growth. That's purpose-built, uniquely different from the competition, and it's happening across our entire cloud portfolio. No one else in our space is doing this.

Marquette University's Senior Director of Advancement Information Services told us, and I'll quote, "Implementing Blackbaud CRM has allowed Marquette University to achieve its goals of supporting its growing fundraising needs and empowering users from across all 11 colleges with a consistent, comprehensive user experience. The solution is successfully bringing together departments across campus and gives us a true 360-degree view of our alumni and donors."

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Offering purpose-built cloud is advancing our ability to sell. And as you know, we've been laser focused on driving improved productivity within our existing sales teams through common procedures, training, key operating metrics, compensation plans and reporting.

In the first half of 2018, we made solid gains in our productivity measures resulting in our best bookings quarter in company history, and we have considerable opportunity ahead. We poured the foundation to develop a highly productive and scalable direct sales model, and we're now planning to ramp sales hiring into the second half of 2018 after holding our headcount largely flat to last year in the first half of 2018.

Let's turn to our third strategy, which is TAM expansion. We're continuing to expand TAM into new or near adjacencies with acquisitions and planned investments. We've been executing this strategy for several years now and expanded our TAM primarily through acquisitions, which have added roughly $2 billion to our $8 billion total addressable market. With the introduction of the Blackbaud Cloud Solution for Faith Communities, we're now in a position to organically build as an option and not just acquire incremental TAM.

There are over 300,000 faith-based organizations in the United States alone. And giving to faith-based organizations was roughly 1/3 of the $410 billion in total contributions last year. This is a massive TAM and tremendous opportunity for Blackbaud to now bring to market a purpose-built, comprehensive cloud for the faith vertical in a market that's comprised primarily of legacy point solutions vendors.

We've also continued the integration work on JustGiving and Reeher. And we remain active in the evaluation of future opportunities to expand our TAM through acquisitions and internal product development.

Our final strategic initiative is to focus on operational efficiency to strengthen the business and deliver improved profitability. We continue driving with a more scalable operating model that creates efficiency and consistency in how we execute through infrastructure investments, productivity initiatives and organizational realignments.

In 2018, we've been executing a cohesive workplace strategy to better align our organizational objectives with our geographically diverse workforce, which numbers roughly 3,000 in total. In Q2, we moved into our new global headquarters and the employee feedback has been overwhelmingly positive. The ecofriendly facility is incredibly dynamic and collaborative, offering leading-edge technology that connects our global workforce like never before.

It's truly world-class and it's not just for our employees. It's also home to the new Blackbaud Innovation Center, a high-tech meeting space for customers, partners, community leaders and influencers across the industry to convene to turn action into impact.

For our employees outside of Charleston, South Carolina, we're leveraging WeWork to replace and upgrade some of our existing offices and expand our footprint into new locations. We've already successfully transitioned 6 of our offices, moving our employees into highly modern and more collaborative facilities that are more centrally located for our employees and closer to our customers. The key for us is optimizing our office utilization, improving our geographic coverage and enhancing our employees' daily experience to improve productivity and effectiveness.

Overall, I'm pleased with our strategic shift towards subscription-based, reoccurring revenue; the innovation we're delivering to our customers and the opportunity ahead of us in 2018 and beyond. I'm also excited about our opportunity now in the faith-based market. I think we can be a true game changer for these important institutions.

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 and the investor materials posted to our website for the full detail of our Q2 financial performance. Today, I'll focus on key highlights so we can get to your questions.

Our second quarter revenue was $215 million, an increase of 4.8% on an organic basis over 2017. Recurring revenue represented 90% of total revenue, which is 340 basis points higher than Q2 of 2017, an 8% growth on an organic basis.

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We continued reducing the mix of onetime services and other revenue, which is positive for the long-term outlook, but creates a significant drag on total company revenue growth for the near term. Onetime services and other revenue represented 10% of total revenue mix and declined 17% versus Q2 of 2017. We anticipate services revenue will continue to decline in 2018.

Turning to profitability. Our gross margin was 61.4%, a 100 basis point improvement versus Q2 of 2017, which is particularly strong. We generated solid operating income of $45 million, representing an operating margin of 21.1% and diluted earnings per share of $0.69.

It's important to note that we're still expecting the full year to land within our guidance of 20.6% to 21.0%. I'll point out that the strong operating margin performance is inclusive of our new church management solution investment, which is being developed internally.

And as Mike mentioned, we've seen solid gains in our sales productivity today and plan to ramp sales hiring heading into the second half of 2018. We don't expect to see material top line return on these investments until 2019 and more fully, in 2020 as we onboard and ramp the incremental new account executives.

Moving to the cash flow statement and balance sheet. Our Q2 free cash flow was $42 million. We continued making necessary innovation and infrastructure investments to support our move to the cloud, amounting to $4 million in CapEx, primarily associated with our new headquarters and investment in infrastructure; and $9 million in capitalized software development cost.

During the quarter, we paid out $6 million in cash dividends to shareholders and ended with $451 million in net debt. Our capital strategy calls for a debt-to-EBITDA ratio of less than 3.5x. And the at the end of Q2, we stood at 2.2x.

Turning to the full year. Mike mentioned that we're making key 2018 incremental investments as part of our workplace strategy. We currently expect to incur, before tax, restructuring costs associated with these activities of between $6 million to $8 million with the majority of these costs expected to be incurred through 2019.

In the first half of 2018, we recorded approximately $4.5 million in restructuring charges associated with this initiative. We're expecting to gain operating efficiencies beyond 2019 with an estimated payback of roughly 2 years and future annual before-tax savings of between $3 million and $4 million beginning in 2020.

We are reiterating our full year guidance issued at the beginning of the year. And with the first half of the year now behind us and based upon our projection for the rest of 2018, we're anticipating coming in at the low end of our guidance ranges.

Our payments business, which is less predictable than our contractual recurring revenue, is still exhibiting healthy growth but coming in lighter than we originally expected, a portion of which is associated with the JustGiving business and U.K. market dynamics. I'll note that we've not expanded that offer internationally and still anticipate bringing JustGiving to U.S., where giving continues to exhibit strong and stable growth, as Mike mentioned.

Mike also mentioned that we're placing emphasis on hiring sales headcount, heading into the second half of the year. And given we're primarily a direct-to-market sales model today, the headcount will fuel growth in 2019 and beyond as we train and onboard these new account executives.

We're continuing to execute against our strategic plan, which is strengthening the business. And we're maintaining our disciplined approach to balanced investments that drive growth and improve 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.

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We will now take our first question from Tom Roderick of Stifel.

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

So Tony, I want to kind of go through your comments on sales productivity relative to guiding us to the lower end of the range for the revenue and earnings line for this year. So maybe if you just unpack that a little bit and start, if you don't mind, with some of the productivity comments again for the quarter. So if this is the best bookings quarter you guys have had, why is that at odds with the guidance still kind of coming down a little bit for the rest of the year? And to the extent that that's on the payments side, not subscription, what needs to be done to sort of reinvigorate that? Or is it just sort of less predictable?

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

Tom, sales productivity, as you know, we've been very focused on putting in the processes and systems and practices to improve productivity. We've installed a whole new set of metrics over the last couple of years and have been pushing hard to get overall sales productivity up. And that's been part of the constraint we've put on ourselves of not ramping sales and marketing investments faster. And as Mike said in his comments, we're relatively flat on sales headcount and expect to ramp that in the second half.

We'll talk more about that at our upcoming Investor Day about our longer-term plans on investments in sales and marketing, and what we think that does for the future. But we feel comfortable that we're on the right track from a gain in productivity, and have good line of sight to where we want to get to over the next few years on that front.

As we said, we had a great quarter from a bookings perspective. Obviously, with most of that being ratable at this point, with 90% of our business being recurring, that's going to take a bit of time for that to turn into revenue. And again, it was Q2 bookings, so we will see some of that in the second half. But obviously, a big portion of that would have been planned in our guide.

Overall, from an earnings perspective, we're sticking to the low end of the range. The biggest piece on the revenue side really is the onetime services. We anticipated that to continue to decline as we saw last year. It's running ahead a little of where we thought we would be on that decline -- rate of decline. And then payments, it's just a little -- as you know, a little bit less predictable in their seasonality. It seems we've not had as many events that drive a lot of the payments business this year. We talked a little bit of that in Q1 and the tough compare to the prior year there with the elections. We've seen a little bit of that continue.

And then JustGiving has been a bit more unpredictable in the U.K. market. And that overall market seems to be a little bit softer year-over-year than what we anticipated.

I think the last piece on the second half that probably dragged a bit on revenue expectations is we've had some favorability in currency in the first half. And we expect that largely to reverse in the second half.

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

Okay, got it. Mike, I wanted to kind of shift gears here and talk about faith-based initiatives. So this is a pretty big deal, I think, relatively to how you guys have historically gone after new markets with M&A, to develop this in-house, go after this organically. Should we look at this as a market where you looked at the opportunities from an M&A perspective, they didn't appear to be there, or the valuations weren't right? Or is this still an opportunity to accelerate different parts of the solution via M&A going forward? How should we think about, how long it'll take you to kind of gain scale in a new market like this?

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

Yes. Sure, Tom. Yes, we did look at the market like we look at all of our verticals, and we do understand quite well the players out there. We wanted to come at this with a very comprehensive platform, which is a key differentiator for us. If you just look at the presence we have today in the market, it's predominantly financials and fundraising and in some cases, online marketing. And the Church Management, which we built, which is the new part of this cloud, has 10 different modules that we built. And once they're live, they are, by architecture design, a part of the existing fundraising and financial environment, so there's no integration.

We felt that we could build a better system than we could buy from an M&A standpoint, and we felt that having a platform that was a single platform, like the customer reference I mentioned in my prepared remarks, just that one customer is going to be able to replace 11 vendors. And so we came after this in a little bit of a different way because of the M&A environment, and we felt that we could just build a much better platform much faster than an acquisition in this particular case.

It doesn't mean that there's a change of strategy from an M&A standpoint. That remains. What it does mean though is we have a very viable option, given the maturity of this SKY architecture, to have a real build decision versus a buy to expand our TAM, which is pretty powerful from a capability standpoint.

Time frame, we will have -- first of all, we have a lot of customers in the space. We have a dedicated sales team in the space selling financials and fundraising. We're adding to this one cloud Church Management. We will have early adopters using the Church Management new platform this fall, with general availability next year.

Operator

We'll now move to our next question from Rob Oliver of Baird.

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

This is Matt Lemenager on for Rob. I just had a question on the best bookings quarter in company history. What -- the question I had was around durations. Was there any meaningful change in duration, customers maybe signing longer contracts? Or maybe no change there? And I guess similarly, were there any deals that closed a bit earlier than expected? It's a good thing to have the deals coming. I just -- with the seasonality and having this such a strong quarter in the second quarter, I didn't know if any deals came maybe earlier than expected.

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

Matt, it's Mike. No, no big change related to your questions. On average, we sign 3-year contracts. And when I say on average, I mean almost every contract's 3 years. I don't mean we signed some at 1 and some at 8. So pretty much we sign 3-year contracts, and that hasn't changed.

What's changed is just the build up of the focus on productivity in the last couple of years. Tony mentioned earlier, and I've been talking about this on the calls for a while now. Our sales 2.0 program, which includes a lot of things: headcount ramps in the last 2 years, information systems, one common compensation plan focused on reoccurring revenue. All coming together, a couple of new verticals. We stood up in the last few years like higher ed and health care. And we've just created a single global selling engine that's coming to fruition.

So productivity in general has been a massive focus of ours. We added 100 folks in sales combined in '16 and '17, kept it relatively flat year-to-date because we just had a big push on productivity, and we're seeing productivity really come up nicely. And that is resulting in a really good quarter in Q2 and resulting -- given our margin performance and the fact that we're going to ramp headcount in the back half of this year as well. So nothing unusual. It's just a build of the productivity program that we've been working on for a couple of years.

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

Mike, that's helpful. And on that ramping of the sales headcount, is there any kind of ballpark -- not looking for an exact number. But what, if it was 100 folks in 2016, 2017, roughly what it might be looking to add in the back half of the year and into 2019?

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

Yes. We're not going to mention what that is because there's a lot of dynamics of how fast can we hire. It's an aggressive program. We mentioned it in the call because it's more aggressive than we have done historically. But we're not going to break out any numbers. And as you know, we break out total headcount at the time of the K, which will be in the K again when we publish that next year. But I don't want to give you a number because we've got a lot of folks working on hiring. And based on finding talent, if you haven't had a problem with, I'd rather not give a number. But it's a more aggressive program that we've had historically.

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

And we'd expect that -- to give you guys a little more insight into that at our upcoming Investor Day, where we'll talk about those longer-term plans in more detail.

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

Which is October.

Operator

We will now move to our next question from Justin Furby of William Blair & Company.

Justin Allen Furby - *William Blair & Company L.L.C., Research Division - Research Analyst*

Several thoughts are running through my head, so I'll try to be concise. I guess, Tony, maybe for you first on the guidance. Just to be clear, in terms of sort of the lower end on the revenue side, how much of that is recurring? And your view of recurring revenue changing versus the nonrecurring and other.

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

Yes. Justin, we're only guiding to total revenue, so I can't give you any specifics at this point. We're not changing that. There's a mix. Onetime services is the biggest drag, obviously, right now, that we've seen. I think we're off 17% Q2 versus Q2 last year and off 12% year-to-date. So that one continues, like we saw last year, to be a really big drag. That said, there is some softness in the payments portion of recurring revenue. And that, like I talked about earlier, really is unpredictability, timing of events. And then we've seen some softness in the U.K. market associated with the JustGiving acquisition. Overall, the maintenance and kind of recurring subs numbers look good. But that's about the most I can give you right now.

Justin Allen Furby - *William Blair & Company L.L.C., Research Division - Research Analyst*

So for organic growth sort of (inaudible), Tony, should it be similar part -- should organic growth be similar to the margin this quarter or lower? Like what are (inaudible) the rest?

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

Yes, sorry Justin, we're guiding only to total revenue. I'm not getting into that granularity. We're not guiding to organic any longer. I think you can take the overall guide, knowing that revenue at that low end and look at what onetime has done and back into roughly what you think you'll see on the recurring side. And I think you've got fairly good estimates on the acquisitions and their impact on the full year, so you should be able to get back to that.

Operator

We will now move to our next question from Rishi Jaluria of D.A. Davidson.

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

Mike, on the faith-based side, again, they're all accolades on the call. You're getting -- an exciting place to enter. I know you mentioned this is mostly an internally developed solution as it was to acquire technology. In terms of the products in the portfolio, is this mostly brand-new applications? Or is there an element of existing applications and modules that you have that you've been able to retool for churches? And alongside that, what sort of incremental sales rep hiring is necessary to maybe appeal and reach that subvertical? And I have a follow-up for Tony.

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

Sure. So a couple of things there. In the faith-based market, we already have a lot of customers. And those customers have been using products, like Raiser's Edge NXT and Financial Edge NXT for fundraising and financials. Some cases, the larger ones also would add Luminate for higher-end digital marketing and some payments solutions and analytics. So sort of our core solutions we sell in multiple markets, we have a lot of customers in faith based using those existing platforms.

What we built are 10 brand-new modules from scratch using the SKY platform that are the modules that run the operations of the church. So you can think of it, and you've heard us talk a lot about the K-12 market over the years. Where we traditionally had fundraising and financials and digital marketing and payments and analytics, and we added the solutions that run the schools. That was through an acquisition a little over 4 years ago. This is equivalent in that it is the modules that run the operations of the churches, but we built it from scratch in SKY. And the reason we're able to do it and go so fast is because when you build in SKY, you start with a very significant lead, if you will, because of the existing components that are deployed, like reporting and e-mailing and user experience are already there. They don't need to be built. So these are 10 modules for churches we built from scratch and will be in early adopter mode. The customers are already signed up this fall. Those are brand new. And when those are live, because they're in SKY, there is no integration work to do to integrate them to Raiser's Edge NXT or our other products that are already in SKY. Because integration is inherent in the fact that we built those in SKY. So a very productive way to build new solutions, again, built from scratch, 10 modules that run the churches.

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

Got it. That's helpful. And Tony, when you're talking about the payment side...

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

And your second question...

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

Sorry, go ahead.

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

Yes, I was going to add your second question again was around sales headcount ramp. Some of the ramp is for faith based, but not all of it. Some of it is across the board in many of our verticals, given our productivity improvements and year-to-date performance. So faith based, again, we have a dedicated vertical team that are now going to sell the whole cloud solution. We will ramp there, but we'll ramp in other markets as well.

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

Got it. And Tony, I mean you mentioned that JustGiving hasn't been extended yet from the U.K. to the U.S. market. Given the acquisition closed about 10 months ago -- and has that always been the plan that it would take this amount of time to extend it geographically? Or has anything changed in terms of the market that has led to maybe what feels like pushing back that expansion time line?

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

Yes. No, that was actually right in line with our original time line. You've got to build the infrastructure for all of that and get the right folks onboard. There's quite a bit of work to do. We had to do work on the product itself. You've got to build some relationship on all the processing side of the donations, the integration with our other products. So there's quite a bit of heavy lifting to be done behind the scenes to get it ready to be a big success in the U.S.

So we're bringing it to the market in a different manner than what it would be offered in the U.K., much more integrated with our other products set. And we'll certainly be focused on a different approach here, being that it'll be coupled in more timely with our other products to give our existing customers more value in the U.S. I would expect that to launch in 2019, kind of general availability.

Operator

We'll now move to our next question from Kirk Materne of Evercore ISI.

Peter Marc Levine - *Evercore ISI Institutional Equities, Research Division - Research Analyst*

This is Peter Levine in for Kirk. So just 2 quick ones. The first one is, the faster expect -- the decline in services, is that more due to kind of handing off more of that to partners?

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

Peter, it's Mike Gianoni. We've been talking about that topic for 3 years now, and I don't know how long you've been on our -- watching us. But that's a decline in onetime services that's built into our plans. Our reoccurring revenue now is a little over 90%, which is a pretty big increase in the last 3 years. And services, going backwards, is actually been forced by the fact that we're fully in the cloud, and we don't have services for license implementation. So it's sort of lightweight services. At the same time period, we've almost tripled the margin in the services business in the last 3 years.

So it's part of the strategic plan of the company. So it's down a little bit more than we anticipated, to Tony's point, it's down 12% year-to-date, 17% in Q2, down a little faster than we thought, so it's a bit of a drag on total company organic growth. But again, 90% reoccurring revenue, which grew

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organically at 8%. It's just part of the shift that we've made in the company. And so I feel -- and Tony and I both feel it's good news to have that become a smaller part of the total revenue. Happened a little bit faster than planned, which we're fine with.

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

And then Peter, I'd add to that. It's not partner-driven. So we really haven't built up that side of the business. We do expect that we've got a big focus, as you know, with Brian moving in his new role, that we'll build out our partner networks and VAR channels. That's a good opportunity for us for growth for the future.

That's not really the impact you're seeing today. The bigger impact to date is, to Mike point, moving to the cloud, less need for customizations implementations, those kind of things. And then secondarily, we talk about during the last call, we've move quite a bit of our onetime kind of offers to recurring, and so we're starting to sell some of our analytics services and some of the other high-value training and other services in a recurring kind of subscription model instead of onetime. And so that's also shifting some of those up into the subscription line. Those, we talked about last quarter, actually are creating a little bit of a drag on our overall recurring revenue growth because they typically grow slower than our normal subscriptions would. So that's also part of the impact on that line.

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

Yes. I'll just add that the partner program focus is predominantly focused on reoccurring as well. We're not going to have a partner program focused on onetime, so because it's in line with the cloud portfolio that we have today.

Peter Marc Levine - *Evercore ISI Institutional Equities, Research Division - Research Analyst*

Another question. You guys talked about the build versus the buy for the new faith platform. I mean, are there other verticals that you guys are exploring now that you could build into or even acquire your way into other -- just other spaces that you're exploring?

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

Yes, there are. We've been fairly acquisitive the last 3 or 4 years. And so we're quite known to be so, which means there's lot of inbound activity. We do a lot of outbound work related to strategic planning by vertical market, including potentially new near-adjacency verticals. And so that is just an ongoing function. We have a small team that spends all of their time looking at those opportunities.

Operator

Brian Peterson from Raymond James.

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

So Mike, could you dive into the bookings commentary a little bit? And could you maybe help me on what specifically drove the productivity improvements? I know that's a key focus for you guys, but I want to understand, is that mostly from a new logo perspective? Or is there something within one of the individual products that's really improved over the last quarter or 2?

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

Yes, sure. We don't break out products, as you know. But from a productivity standpoint, this has just been building for a couple of years. Just recently, we have everyone on the same comp plan, and it's a comp plan focused on reoccurring revenue. And so it's a big drive for us from a sales,

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bookings and comp standpoint to drive reoccurring revenue. Also, as we continue to build out these cloud -- vertical cloud solutions that have more modules in each of the vertical clouds, it drives higher ARR. And so because there's more to sell for net new customers, there's more to sell -- cross-sell back to the base as well. And so we continue to drive productivity in bookings and in our ability to add modules and TAM by vertical. And it's just, again, it's a continuation of the sales 2.0 program that we've been driving for the last couple of years just generating the results that we anticipated it would.

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

Got it. And Tony, forgive me if you guys mentioned this. But last quarter, I believe you said that organic recurring revenue, the low point would be in the first quarter. I know there's some moving parts related to payments in the back half of the year. But is that still the case as it relates to the first quarter?

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

Brian, at this time, we're not going to update anything on the organic -- not guiding to it. We did say last quarter, we expected that to be the low quarter. So I'll have to stick with that at this point. I think as we've talked about earlier with Justin, I think you have the information. You should be able to back into that relatively closely. I think the wildcard for all of this, the 2 big moving pieces is, what is services due for the full year, the onetime services? And then, where does currency end up? Which is, as well, are trying to figure out where the U.S. dollar will go. Want to see where that shakes.

One other thing I'd add to the point that -- on your first question with Mike would be on the productivity. One of the other things that we've seen as been very positive is acquisitions. We've done some really good acquisitions, and they've been accretive. And we've seen some really positive results on Reeher already, and AcademicWorks continues to be a very positive result for us as well, which are driving nice bookings productivity also.

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

Yes, 2 key things for me related to that is, again, reoccurring revenue at 90.2% of total in Q2, and organic reoccurring revenue at 8% in Q2, which is really strong numbers for us.

Operator

We'll now take our next question from Jason Celino of KeyBanc.

Jason Vincent Celino - *KeyBanc Capital Markets Inc., Research Division - Associate*

I'm on the line for Monica this morning. You kind of mentioned with the ramping sales for the back half this year and with the new faith-based solution, I know you're not necessarily guiding to organic revenue, but how should we think about organic revenue growth going forward? Should we kind of see it accelerate maybe '19 and '20? How kind of how are you thinking about that?

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

Yes, for faith based, a couple of things: One is -- and again, I used one customer example in my prepared remarks, and it's a good representative example with a customer signing up for the whole cloud. And we have customers signing up like that for the whole solution. By being able to implement things like financials in fundraising now and then either being an early adopter for the new Church Management modules that we built in the fall, we're waiting to get those implemented in general availability next year. So it's going to take a while to ramp up the new platform,

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obviously, in faith based, but we believe we can accelerate the platforms and solutions that are available today given the whole comprehensive cloud that we just announced.

So we will be ramping headcount, as I said, sales headcount in all of our verticals, including the faith-based one at a pace that allows us to go after that marketplace. And we really believe, after studying this market for a couple of years, because again, we've been in the market, that this platform is a game changer. No one has done this, and I don't believe can given the capabilities we have with our SKY architecture.

Jason Vincent Celino - *KeyBanc Capital Markets Inc., Research Division - Associate*

Okay, that's helpful. And then you kind of mentioned some softness in the U.K. market for JustGiving. Can you maybe go into a little bit more detail on what specifically is driving that?

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

Yes, just in general, if you look at the size and growth of the U.S. giving market versus the U.K., the U.K. is not nearly the size or nearly historically gross like the U.S. market. So it's a bit softer just in general. And it's also like the U.S. market is event-driven, too, right. So if you have a lot of events, they just naturally gravitates folks to make donations, which drives revenue in that particular platform. And so it's event-based as well, which is obviously out of our control. So it's a little bit more -- less predictable, that particular product in that market. And that product is predominantly drives its revenue today from that market. It will drive more revenue from North America in '19 and beyond, as Tony mentioned. And again, if you want to -- it's one product in the portfolio.

Yes. I could tell you that on the other side internationally, our portfolio and our sales teams are really doing well. That sales productivity discussion I've mentioned year-to-date, that very much includes our sales teams around the world in the Blackbaud side around digital marketing and fundraising. We're doing extremely well in our international markets.

Operator

We will now move to our next question from Ryan MacDonald with Needham & Company.

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

First question for Mike and then a follow-up for Tony. Mike, I'm not -- on the Church Management side, an opportunity there. You mentioned over 300,000 organizations in the U.S., and you already have a customer base with some other solutions in that area. Is there any select target vertical that -- or a target subsegment of the 300,000 that you're starting to focus on? I think on some of the work we've done, there's today about 1,200 or so megachurches, you could call them, in the U.S. And then also, is it a first to focus on expanding within the existing customer base with the Church Management solution or more of attacking net new logos?

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

Yes, Ryan, it's -- that's a good question. It's a little bit of both. So a lot of these institutions have a hierarchy church size, right. And so if you pick a particular denomination, they might have a couple of megachurches, many sort of midtier and many smaller churches. This cloud solution fits that all, and it's a different module type by institution as well. So for example, the Church Management new modules that we've built will fit all sizes of the church. But then in their hierarchy of churches in one denomination, the larger, midtier or the larger megas might be the only ones that would have a centralized financial or fundraising platform, yet all of them will have Church Management. And they're all a little bit different.

So we've built this cloud solution that scales up and down for all of them, which is also pretty unique. We are, obviously, talking to existing customers that have been customers for years of Blackbaud. We're also talking to net new customers, and the go-to-market model fits what we've deployed

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in the last several years, which we have sales folks focused on cross-sell back to base, in other words, adding the new Church Management Blackbaud-developed platform to existing; and then net new, which are potential customers for all of the modules, fundraising, marketing, financial, Church Management, so we're doing both. So we're not exclusive to either cross-sell or net new. We're doing both.

And I mentioned in my prepared remarks, we thought the market response was going to be tremendous, and it has been from just an inbound standpoint. No one is doing this, and it's the first time that there's an integrated, single-cloud platform. And again, my one example I used, replacing 11 small single-point vendors, there are significant operating improvements with a single integrated cloud replacing 8, 9, 10, 11 vendors, which requires the church to be the systems integrator. So I believe it's the game changer, and it's going to take time, right. It's all -- it's cloud, so it's ratable rev rec. It's going to take time to get this fully realized in the marketplace, but it's a big market. Several hundred thousand churches and donations in this space, it's the largest part of the $410 billion in donations last year. It's the largest segment just on the donation side as well. So we're pretty excited about what we're doing here.

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

Right. That's really helpful, Mike. And then quick follow-up for Tony. Tony, you mentioned about the -- talked about the softness in the payments portion of the recurring revenue. Is that something -- when you discuss that, I guess could you go in a little more detail? Is that more on adding new customers with the payments module? Or is this a sort of a greater softness in, say, donation volumes perhaps from some of the tax reform changes that we've seen thus far this year?

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

Yes. I think it's softness, more, Ryan, just because of timing of events or a number of events in the market, and softness like in the U.K. market, as Mike spoke to with JustGiving, less growth there. Unfortunately, many of these events are natural disasters or other kind of things, and so we're kind of beholden to what happens on that front.

The other thing is we still have some impact on the -- it hits the payment side as well and just all the products we're sunsetting. One of the largest products is our old Sphere, Kintera product. And that has quite a bit of payments associated with it. And so as we go through that, as we've spoken many times before, we have higher churn on those kind of legacy products that we're rationalizing out of the portfolio. So that drives part of it.

Overall, I think our kind of win rate or continued penetration looks good. So I feel pretty good about -- on that front, the number of net new customers we're adding. We're continuing to look for areas in the future where we can add payments capability to more of the portfolio. And so I feel good on the long term. I think it's more of just kind of this seasonality, not anything more specific than that.

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

Yes, and I'll add that we are -- our win rates are good. Even with larger customers, it's really ramped up nicely, adding them to the payments platform. And again, 8% organic growth on reoccurring, even with all that going on, we're pretty pleased with the results and kind of where we're heading.

Operator

We will now take our next question from Mark Schappel of Benchmark.

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

Michael, with respect to your faith-based initiative, who are the principal competitors that you expect to see in the space?

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

There's a bunch of companies out there. One of them is called Ministry Brands. One is called ACS. There's several others. There's some payment-only ones out there. There's a company called Pushpay. So they're all sort of single-point solutions that don't have a -- this comprehensive cloud.

And what we have going for us is we have world-class platforms already in the space, like fundraising and financials and digital marketing and analytics. And we have a core payments platform, which we built on in this new faith-based cloud, and then these 10 new modules. And that represents -- I just mentioned a couple of the larger players, but what I just mentioned represents a dozen companies. And in our cloud, it's a log on ID with one user experience for all of that capability. And so an institution can start with -- I want to implement fundraising and then I want to turn on the next one, the next one, the next one, meaning the modules, and not have to go through another vendor and another implementation process and another professional services process and another contract. And it's daunting to do that as a smaller institution without a ton of IT resources, and we are displacing the need to do that.

So there's a lot of vendors out in that space, lots of them. I just mentioned a few, so we -- again, I think that this is a game changer for us. I've been in software my whole career, and I see this as a really big opportunity for Blackbaud and a really big opportunity for the customer to improve their operations and a lot of operating problems and challenges in the space. And it's a big space, and the numbers are big. They -- these institutions roll up numbers to corporate, and it's difficult to do that. You have people that are focused on their mission or their church, and they also have to run the operation. It's really hard to do that. And so we think this is going to be really, really impactful for the churches.

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

Great. That's helpful. And with respect to the other faith-based initiative, are most competitor products sold through a channel? Or are they typically a direct sell?

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

No, they're mostly direct sell. A lot of it's on the phone, mostly a direct sell. And we're a direct sell model, right, so it kind of fits in with what we do. And we're putting the whole power of Blackbaud behind this, so I've talked a lot about in the script the cloud platform and the power of SKY. But remember, we will wrap this with everything that we have, right. We have a very well-run, very highly utilized online education tech business. We'll wrap all those capabilities around this faith-based cloud for online training. We will add our analytics capabilities here, which is unique in this whole space. We will leverage our payments core platform, which is a substantial platform when you plank it toward this space. That's a part of this cloud, right. These things we don't have to build new. We will leverage the fact that we've got a very large call center for support, a very large professional services team for implementations and best practices. We will leverage our go-to-market marketing teams and product management and product marketing.

So I talk about the tech, which is the cloud solution and what that provides. But what also differentiates Blackbaud in the space is everything around the software, right. The whole company, all the things that we bring, we have a platform for online communities. We have tens and tens of thousands of online customers that use our community platform for free, and they talk to each other about best practices. All those things don't exist in the faith-based market at all, so all that's additive to this cloud that we just built and deployed. Again, the full power of Blackbaud is getting pointed toward the space, and you can probably tell I'm pretty pumped up about it.

Operator

We will now move to our next question from Kevin Liu of B. Riley FBR.

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Kevin D. Liu - *B. Riley FBR, Inc., Research Division - Senior Analyst of Software and Business Services*

Just in terms of the booking strength you saw in the second quarter, I was wondering if you could characterize how much of that was driven by kind of conversion activity versus new logo strength?

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

It's pretty balanced actually. We're seeing new logo strength really do well. We're seeing average size of deal getting a little bit bigger because, again, we're selling multiple solutions. We've really changed to a solutions selling organization as opposed to product only. So it's pretty well balanced between cross-sell and to existing and net new. And again, our cross-sell opportunity is just massive. We talk a lot about the K-12 space. Historically, there's over 30,000 addressable schools, and just the cross-sell in our existing base is big. And then the go get for net new, just in that vertical, is pretty big. We're not scratching the surface yet on net new or even cross-sell, so thus our focus on productivity.

Kevin D. Liu - *B. Riley FBR, Inc., Research Division - Senior Analyst of Software and Business Services*

Great. And then Tony, just on -- capitalized software ticked up in the second quarter. Is that reflective of just more visibility into the timing of Church Management launch? Or are there other development efforts driving that? And what should we expect for capitalized software in the back half of the year?

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

Yes, Kev. We've had a big focus on rationalizing the portfolio and improving overall quality of our code, which means with our total R&D gross dollar spent ramping up and then with the acquisition, we're spending more dollars on innovation, is what that all results, and as you and I have talked about before. I think the ramp versus Q1 has some seasonality in it as well, because you're having the holidays and people taking time off coming into January, so that adds a little bit of impact on cap software. But then certainly, some of our ramped innovation spend building some of these products, like what we've announced here for faith, certainly has an impact on that cap software.

For the year, we had guided the CapEx in cap software of $45 million to $55 million. That's up a bit from where we'd normally expect to be running because CapEx is going to be $10 million to $12 million higher, somewhere in that ballpark, because of our new headquarters built, leased, coming online this year. But we still expect that $45 million to $55 million to be a good number for the full year.

Operator

We will now take our last question in the queue from Pat Walravens of JMP Securities.

Mathew Edward Spencer - *JMP Securities LLC, Research Division - Associate*

This is Mathew Spencer on for Pat. I guess if you had to pick one maybe, what is the biggest single challenge facing the nonprofit organizations today? And maybe you could break it down between K-12 or higher education or faith or any of those if there's a drastic difference.

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

Yes, there's a -- this is Mike. There's a big difference. So from our view to the market, it really is our biggest challenge and our biggest opportunity, which is to help them go through a digital transformation, like every industry is going through. And that's what we're focused on. They all have to go through a digital transformation, whether they're a charity, a K-12 school, health care, a church, or higher ed. When you get into their challenges from their view, it's up -- it's quite different, right. So faith based is keeping participation up in the churches, which has been going on for a couple of decades. Higher ed, it's the mix of an online digital education as opposed to a student coming to a physical campus. I mean, they all have different

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-- health care is in it's own spot given government participation and insurance and Medicare, right. Those are all the mega -- just the mega things by vertical, which is quite different, right, for all of these verticals.

But again, from our view, this is such a large addressable market, and they all need to and are on some path to have a digital transformation. And that's what our focus is. And that's a challenge and an opportunity for them and for us.

Operator

As there are no further questions in the queue, that will conclude today's answer-and-question session. And now I would like to turn the call back to Mike Gianoni for any additional or closing remarks.

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

Thanks, operator. I'll just close by saying that our commitment to develop and deploy a fully integrated end-to-end cloud for the faith space, as you heard this morning, is a game changer for churches and a massive opportunity for Blackbaud. We also continue to execute against our 4-point growth strategy, as I updated everyone on the call. And Tony and I look forward to updating you all on our progress on our next call. So thanks, everyone, for your participation this morning.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.

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