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# EDITED TRANSCRIPT

BLKB.OQ - Blackbaud Inc Conference Call to Discuss Long-Term Financial Goals

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## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by, and welcome to the Blackbaud Long-term Financial Goals and Strategic Outlook Conference Call.

(Operator Instructions)

Please be advised that today's conference is being recorded.

(Operator Instructions)

I'd now's like to hand the conference over to your speaker today, Mark Furlong, Senior Director of Corporate Finance. Thank you. Please go ahead, sir.

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

Good morning, everyone. Thanks for joining our call today to discuss Blackbaud's long-term financial goals and strategic outlook. With me on the call are Mike Gianoni, Blackbaud's President and CEO; and Tony Boor, Blackbaud's Executive Vice President and CFO. Mike and Tony will make prepared comments, and then we will open up the line for your questions.

Today's call is being recorded and will be available for playback on our Investor Relations website. 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



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considered in isolation from or as a substitution for GAAP measures. A reconciliation of GAAP and non-GAAP results is available in the supplemental schedules included in our presentation on our Investor Relations website.

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

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

Thanks, Mark. Good morning, everyone. Thanks for joining our call today. Yesterday, we issued a press release announcing our updated financial goals and posted a brief presentation outlining our strategic outlook on the business, which is available on our Investor Relations website.

We originally planned to release our long-term goals at an investor session early next year; however, we heard from our shareholders and others in the investment community that it would be helpful to provide additional clarity into our expectations for performance during the pandemic and longer term. And given the recent completion of our internal long-range planning cycle, we accelerated the release of our goals, which we'll cover today.

Please note, we will still hold an investor's session early next year to provide a more comprehensive update on the strategic initiatives to accelerate long-term performance. Also note, we do not provide quarterly guidance, and we will not be giving fourth quarter 2020 guidance or full year 2021 guidance on this call. And it may be helpful during this session to review the presentation posted yesterday to the Investor Relations section of our website.

I'll start with some color around revenue and revenue makeup. 93% of our revenue is reoccurring revenue, comprised of contractual recurring revenue, which is roughly 2/3 of our revenue and transactional revenue, which is roughly 1/4 of total revenue. Our contractual recurring revenue is stable and has grown year-to-date through the third quarter of 2020 despite bookings falling short of our original plan. As we previously shared, our renewal rates have trended ahead of our original plan for the year, and our customer retention rate has held at 92%.

The pandemic has amplified the variability of our transactional revenue, which consists mostly of payment processing revenue, but also other transactional usage-based revenues. This usage-based transactional revenue is less than 5% of our total revenue and has been under pressure as customers, primarily in the nonprofit vertical, have had essentially no in-person fundraising events due to the pandemic.

We have retained these customers, but they're currently unable to hold these events in person. They plan to do so as soon as possible, and right now, we think this will turn around in the second half of 2021. But of course, it's tied to the vaccine plans.

We are encouraged with the recent vaccine announcements and hope to see distribution plans come together soon. Also, we've seen a significant shift in mix toward online payments, particularly in the second quarter, which has largely offset the over $8 million decline in other transactional revenue through the third quarter. This heightened variability in transactional revenues create short-term challenges in accurately predicting our revenue heading into December, which is our seasonal high for transactional revenue driven by payment processing.

Post pandemic, we expect most of the declines in transactional volume to recover quickly with a vaccine in place and in-person events back underway, which our customers are planning for. Also, we see bookings likely following a more gradual return to pre-pandemic levels.

With that said, we're hopeful, but not certain, we will be in a position to provide 2021 guidance on our Q4 earnings call. While our markets are experiencing a near-term impact from the pandemic, as we think ahead, it is clear our markets are resilient, and our customers continue to find creative ways to ensure they can continue to deliver on their missions. The vertical markets we serve have a diverse set of revenue streams, impacted various ways by the pandemic. And this ultimately flows through to their ability to deliver on their missions.

I'd like to share a few examples that are representative of some of the challenges and opportunities we're seeing in the market. For our large nonprofit customers that rely heavily on event fundraising through our Luminate TeamRaiser solution, we initially saw a sharp decline in event volume, though, we have seen steadily improving results throughout the year as they reimagine events and donors become better accustomed to a more virtual environment.



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For these customers, the total amount raised on Luminate TeamRaiser was down 75% in April, but has been closing the gap in recent months with a 35% year-over-year decline in October. With planning underway for 2021, Blackbaud serves as an important resource as our customers look to improve their participant experience and further close the gap in their fundraising revenues. This is also driving interest in our analytics solutions, which enable organizations to be more efficient and targeted in their fundraising efforts.

Other nonprofits like food banks, shelters, child services organizations have seen significant increases in demand for their services during the pandemic, and our lead generation and pipeline conversion in this area has consistently outpaced last year.

In education, many K-12 private schools have seen strong enrollment as families chose to relocate their children's learning from public to private education, but as to be expected, these schools have limited administrative bandwidth as they manage a host of pandemic-related challenges, such as modifying physical spaces and operating processes or instituting contact tracing and remote ready learning capabilities. This has made for a challenging selling environment as schools focus on immediate needs and delay strategic software evaluations. However, expectations for the use of technology in schools has become more important since the pandemic began, and we are well positioned to benefit as schools look to invest more in educational technology. For example, we've seen a significant increase in the utilization of our education management and tuition management solutions.

In the month of September, usage features like online discussions and assignments were each up over 400% compared to the same period last year and the utilization of online assessments and test was up 300% year-over-year. This translates to substantial value for our customers.

Meanwhile, we're seeing a sense of urgency from corporations and community foundations to provide support to communities as they navigate the pandemic and social justice movements. As a result, there has been strong interest in our new release of Blackbaud Grantmaking helping organizations manage the entire grant-making workflow, including applications, payments and communication with grantee partners all in one solution.

And we're seeing increased demand for our corporate social responsibility solutions from companies looking to quickly build or mature their efforts around employee engagement, volunteerism, giving, grant making and ESG reporting. These are just a few examples of how each of our vertical markets continue to adapt and contend with the unique challenges poised by this pandemic.

But one universal theme is the need to employ new strategies to advance their missions with a more digital-first mindset. We believe this shift will play a powerful role in our long-term opportunity as new customers seek market-leading software solutions for their organizations and existing customers consider expanding the Blackbaud solutions in their tech stack.

This digital-first mindset was a key theme throughout our long-range strategic planning. Over the long term, we have a substantial opportunity to drive meaningful acceleration in financial performance as we execute our balanced strategy with a sharper focus on profitability.

We have multiyear cross-functional strategic programs and projects already in place that put us on the path toward our long-term aspirational goal to achieve the Rule of 40 with mid- to high single-digit organic revenue growth. These efforts are centered around delighting our customers to industry-leading cloud solutions, further optimizing our go-to-market model and driving operational scale and efficiency, all while enhancing the future of work at Blackbaud for employees and delivering increased value to our shareholders.

We're already underway accelerating key product investments designed to improve quality, reduce risk, improve scale and drive agility. And as you know, we've made investments in digital marketing to enhance our digital footprint and enable us to be more prescriptive and cost-effective in our go-to-market efforts.

The pandemic has forced us to place a greater reliance on digital lead generation and selling. And we've taken the lessons learned over the last several months, and reevaluated elements of our go-to-market strategy with a digital-first mindset. We have a significant opportunity to leverage the investments into digital to reduce our customer acquisition cost, increase our sales velocity, ultimately, driving a more scalable and cost-effective go-to-market model.



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As I said earlier, we'll provide greater insight into these initiatives when we host our investor session early next year. Before I pass the call over to Tony, I'll just summarize by saying our customer base and contractual reoccurring revenue is stable and growing, despite the challenges posed to our customers during the pandemic.

We have near-term durability in our revenue outlook, driven mostly by our transactional revenues, but also a tougher selling environment. So in line with our strategy, we made a pivot to place greater emphasis on delivering shareholder value through increased profitability and cash flow, which are more controllable. In the post-pandemic timeframe, we are well positioned to drive meaningful acceleration in our financial performance in the context of the Rule of 40 and we are already underway executing against the strategic plan that will move us further toward our long-term aspirational goal of achieving the Rule of 40.

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

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

Thanks, Mike, and good morning, everyone. This morning, I'll briefly cover the financial framework and drivers behind our goals before opening up the line for your questions.

First, please note, we've defined the Rule of 40 as non-GAAP organic revenue growth plus non-GAAP adjusted EBITDA margin. You can refer to the materials posted yesterday to our Investor Relations website for a reconciliation of those non-GAAP measures.

As Mike said, the impacts of the pandemic on our customers causes variability in our near-term revenue outlook, and thus, we've made a pivot to place greater emphasis on profitability and cash flows. The Rule of 40 provides a solid financial framework to assess our progress going forward as we continue to execute a balanced approach to driving both revenue growth and profitability.

As you know, we took early actions in response to the pandemic to meaningfully reduce costs, bolster our liquidity and increase related borrowing capacity. As part of our pivot, we've also increased our focus on ensuring we get adequate return on invested capital. Over the past several years, we've made significant investments, creating an efficient, scalable operating model, and most recently, we increased investments in the sales and marketing with a goal of accelerating our recurring revenue growth rates.

While we were optimistic about the sales productivity improvements we anticipated heading into 2020 and further traction with our expanded product offerings and faith and higher education verticals, the pandemic has put pressure on lead generation and lengthened sales cycles, making this challenging selling environment. And as a result, we rightsized our overall cost structure to better position us to deliver sufficient returns on investment.

The result of our early 2020 actions and reduced cost base is better performance optimization through the third quarter on a Rule of 40 basis compared to the year-to-date 2019 despite some near-term variability in revenue. And we're confident in our ability to maintain at least 25% performance annually on a Rule of 40 basis throughout the pandemic.

Unfortunately, we cannot accurately predict when the pandemic will be behind us, and therefore, we framed our goals to account for that uncertainty. Post pandemic, we have substantial runway to drive meaningful improvement on the Rule of 40 framework through sustainable revenue growth and improved profitability.

The declines we've seen in our transactional revenue will likely follow more of a V-shaped recovery, while the shortfalls in bookings could be more gradual recovery. There's no question the current environment has put a greater emphasis on investing in digital and cloud-based solutions. While we don't yet have line of sight into when this will materialize in pipeline and bookings, we're well positioned as the leader in the market, and we're making enhancements in our go-to-market necessary to capture this growth opportunity.



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We've also accelerated investments into engineering and innovation with a focus on driving value and outcomes for our customers, and we believe these investments combined with our -- combined with building on our customer-centric culture can drive improvements in our already strong customer and dollar retention rates.

In the 3 to 4 years post pandemic, we've set a full year target of at least 35% on a Rule of 40 framework, with mid- single-digit organic revenue growth or at least an 800 basis point improvement from our year-to-date 2020 performance. We're very confident in our ability to deliver a sustainable mid single-digit organic growth rate while driving margin expansion.

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

Our newly expanded real estate strategy focused on optimizing our footprint for the future of work at Blackbaud, includes exit plans for certain office leases around the globe, which will generate significant cost savings going forward and will give us additional flexibility as we evolve our workforce strategy.

As a reminder, we expect the majority of these lease terminations to close during the fourth quarter of 2020 with a onetime cash outlay of between $20 million and $25 million. Our pivot to place a greater emphasis on profitability positions us to significantly improve on Rule of 40 in a post-pandemic environment and gives us heightened confidence on our expected future free cash flow generation. While we have set the Rule of 40 targets using adjusted EBITDA margin, I would also expect significant improvements in our free cash flow margins as we pursue these targets.

Our long-term plans include continued execution against our capital deployment strategy, which calls for ensuring access to adequate levels of capital to grow the business through balance sheet management, rigorous oversight of investments in the business, including acquisitions, and identifying and efficiently returning excess capital to shareholders.

In line with our strategy, we recently amended, expanded and extended our credit facility to provide us additional capacity and flexibility for the future. We also recently expanded our existing share repurchase program increasing the total capacity under the company's share repurchase program from $50 million to $250 million.

We removed our dividend earlier this year as a cash conservation measure. However, we will continue to deploy our capital in close alignment with our capital strategy, which includes the option for opportunistic share repurchases when we believe it is in the best interest of our customers and shareholders.

Overall, there are significant opportunities in front of us to strengthen the business and elevate our financial profile. We are well positioned to drive toward a long-term aspirational goal to achieve the Rule of 40 with mid- to high single-digit organic growth. And we believe that steady execution against this financial framework, paired with our updated capital deployment strategy, drives a substantial increase in shareholder value.

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

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question comes from Tom Roderick with Stifel.



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

Great to hear from you. Happy holidays. Okay. So this is the part where you realized you gave a toy to a toddler, and now they're asking for more toys. So I love the detail on the breakout of payments and other transactional. That's super helpful. As we think about what this all means in the next 12 months, 24 months. And Tony, to your point, the kind of a nice snapback effect in a vaccine -- post vaccine world on that. I'd love to ask a few questions just around the payment side.

So let me kind of take them in 2 or 3 parts here. And I guess the first part would be just what did that mix look like payments a couple of years ago or 2 or 3 years ago? Just so we have a sense of how that's been progressing as a percentage of revenue. And then, I guess, the second part of that would be, as we think ahead to the world as it stands today and just assume that, that world plays out, for 2021, without formally offering us any guidance, I would love to sort of hear about like what does that mean for variability? If we don't see events come back in mass, should we be thinking about payments being a weight on growth next year and be thinking about sort of a negative growth rate? Just some parameters around what happens in a pre- and post vaccine world and what that sort of looks like on a variable revenue world for growth for next year would be a great place to start the discussion.

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

Tom, it's Mike. I'll start off here. First, the -- I think we're going to have for next year, I think we'll -- in the first quarter, we'll talk about guidance. We should be able to, but with that variability, it's been tough. But the primary reason why we pulled guidance because we didn't know what was going to happen with events. And the quarter 3, we just finished is typically a high in-person event because it's over the summer, right. So a lot of large nonprofits have their runs and walks and bikes and things. And so the Q3 was a pretty low quarter for us.

So as events come back, and we haven't been losing customers, right. It's just the events aren't there, so the transactions and the usage isn't there. So if that comes back, it should just turn right back on. To the extent that it comes back, we don't quite know. It's definitely tied to vaccine and people being comfortable attending these events. All of our customers are planning to have them but it's tied to the distribution of the vaccine, which is getting more positive news every day. Saw that U.K. just approved Pfizer was on news this morning. So it's tied to that. So we think that will come back nicely, because those events will come back. And that part of our business, which is a bit of a drag this year, not massive, but a bit of a drag in Q3, as you saw in that PowerPoint that we put together on the website, but it should come back nicely in the future.

So I don't see that being a big problem for us. It's not controllable, but we are not losing any customers. So it's tied to those events coming back. So we feel pretty good about that. And we continue to add customers as well. Sales aren't where we would like them to be, but we continue to add customers in our cloud software and in the transaction side a bit as well.

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

And I think on your mix question, Tom, compared to a couple of years ago, the biggest change is going to be acquisitions. So the mix wouldn't have changed a lot between the typical credit card processing in our BBMS platform or smart tuition or usage at Luminate and TeamRaiser on the big events and runs, walks and rides. As Mike said, those have held pretty steady and have had some good growth.

But the big mix change would be acquisitions of JustGiving and all that we've done on that front and the expansion of JustGiving into the U.S. and elsewhere in the world, some of the tip jar, some of those things have been really positive for us on the JustGiving side. And then YourCause has a bit of transactional revenue as well. So any change in mix wouldn't largely been because of acquisitions over the last couple of years.

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**Operator**

Our next question comes from Rob Oliver with Baird.

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

I appreciate all the detail and the update, really great. Two questions for me. First, on the 3-4-year target, which implies, which is mid- single-digit revenue growth, but does imply, I think, 30-ish percent EBITDA margins, very encouraging. And I suspect we're going to get a lot more detail at the Analyst Day on this. But just curious if you guys maybe could take the opportunity to touch on some of the drivers there as that's a pretty substantial delta from where we are?

And then my follow-up question, I'll just give it now because I think it may tie in to the first one. And that is, Mike, you've spent some time talking about digital-first and the digital Salesforce. And that certainly, I think we'll catch it all for investors' attention, we've seen a shift here towards hybrid go-to-market in land and expand models. And you guys have done multiple kind of Salesforce -- that's probably not fair, a lot of Salesforce changes in recent years. And just curious, is that the right way to read it? Is it a hybrid model? Is it a land and expand model? How we should think about that? So a lot there, but I very much appreciate it.

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

Yes, Rob, those 2 questions are actually somewhat tied together, driving margin and being more digital first. We've been making these investments for over a year now. And we've seen since March, the ability to scale our company through digital means more so than we've had historically.

A simple example is our annual conference went from 2,500 registrants to 38,000 in October. And when you do things like that, you get a lot of leads out of that. We've also been investing in digital lead gen. We put in a bunch of platforms and hired expertise there to drive digital lead gen for our sales teams, which has been a big investment in growing investment for us. The cost per lead is a lot less. We can drive our customer acquisition costs down. And so we've got an opportunity here to continue to drive bookings it's going to be a bit of a tail, though, because the pandemic has put a bit of a damper on bookings.

We're still selling deals and all that. It's different by vertical. Some of our vertical markets are doing really well, year-over-year actually from our bookings growth, some of them are a lot slower, because the institutions we sell to are in a different scenario by vertical. So that's going to be a big opportunity. We also were super aggressive on things like changing the real estate portfolio and kind of what we're doing, we've learned. We can work remotely and not have to have as much real estate overhead. We've talked about that. Tony did in this prepared remarks here, too.

So there are several channels that we've already started, frankly, back in April, that are driving -- or earlier with digital sales lead gen that give us opportunity to drive margin and drive up EBITDA. You saw just in Q2 and Q3 in the very short term, we made some pretty decent headway margin coming at 23% or a little over 23%, which is a lot higher, I think, than expectations.

And that's just the beginning of the journey. We haven't even realized some of the stuff we've already executed on, like the real estate changes, for example. We're sort of accelerating that into Q4 this year. Tony mentioned the use of cash related to that, but the benefits of that start next year. Right, you start to reap the margin benefits of some of these changes. So we think that we've got a lot of opportunity to move up the Rule of 40 here. We started a little bit already in our Q2, Q3 results that we'll continue to march down that path based on the press release we sent out.

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

And Rob, I kind of think about reconciling the numbers for you. From an EBITDA perspective, we've committed and you are already seeing that this year, committing to 25% plus in the midst of the pandemic. Keep in mind, as we spoke about, I think -- I talked about this after the last call, and we talked about it on the call, that we're -- we've got some expenses we're not incurring currently that will come back, T&E, merit, 401 K matches, some of those things we've already said we'll come back in.

We also have several expenses that will go away that we're incurring as a result of the pandemic. So we're incurring additional bad debt and other expenses as well right now. So you've got to -- some of those will offset each other, and then Mike spoke about a lot of the other opportunities. We'll go into a lot more detail at that full investor session early next year, but 25-plus percent now with effectively no growth on the revenue side, assuming this aspirational goals or say midterm, we're going to be in mid kind of low single digits. Somewhere in that mid- single-digit range, I'll





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say, 4% or 5% or 6% growth. So that takes you from a 25-plus to 30 plus. And easily, you've seen us do this in the past 100-plus basis points a year kind of improvement in our overall profitability over 3 or 4 years certainly gets us up to that 35% plus range that we put for that midterm goal.

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**Operator**

Our next question comes from Brian Peterson with Raymond James.

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

I appreciate all the perspective here. So just -- I'll keep this to two parts, I promise. But the first one -- just how is M&A contemplated in these targets? Just want to understand what's organic or M&A driven? And the second part is do you feel that you can reach these growth objectives with your current sales headcount? Or will we see that number ramp up over time?

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

So Brian, first one if I caught that, how is M&A contemplated, is that correct in these numbers?

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

How is M&A contemplated in these targets?

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

Yes. So we would expect that we will continue to be in the market for acquisitions. These -- assumably, if we did any acquisitions, we would expect them to fit within these parameters. So as you know, and as we've looked at acquisitions in the past, we would typically expect them to be accretive to growth of the company and accretive to profitability and cash flows, obviously, incorporating planned synergies. So any acquisition work that we do, we would expect would fit in here, and we would hold to these goals and objectives, aspirational goals regardless of the M&A. Obviously, M&A would just make it a bigger overall revenue number and obviously, profitable and cash flow would be higher.

Second part on sales, I think the wildcard on the sales side, Mike, you spoke to this a bit already on one of the previous questions, it's really about improving our sales velocity on kind of the SMB side of the business. We've done a lot, as you know, over the last 3 years, Brian, to get things in order and the comp plans in place and the hunters and farmer model in place and all of those things. And we expected to see some really nice productivity improvements heading into this year, pre-pandemic, we were doing well in Q1 when the pandemic hits and then the security incident. But as Mike and I had stated before, we have a lot of optimization still to be done on the sales model itself. And so we've got a lot of focus on that front. And over the next 2 or 3 years, we expect we'll gain a lot of productivity.

The size of the sales force, that's something we can talk about more -- in more detail in the spring when we get together for the investor session. I don't think that where we are today that I would expect we'd have more salespeople, or a larger team. I actually think we can gain significant productivity to help drive more bookings for the future.

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**Operator**

Our next question comes from the line Ryan MacWilliams with Stephens.

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

It was good to see growing contractual recurring revenue continuing. Two questions for me. In this near-term period for your financial targets, how can we think about the likelihood of contributions from organic growth during this period? And then can you talk about your thoughts on your buyback program at current levels? Maybe any color around your strategy to deploy capital here would be helpful.

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

Sure. So contributions from organic growth, I'm assuming you're meaning margin contributions. We see organic growth coming back. So you've seen in that PowerPoint we put on the website, we have some organic growth in our cloud software part of the business. The pressure has been on the transaction side. We see that cloud software side continuing the transaction side coming back. When the events come back, as I mentioned earlier, and from a contribution, so that's on an organic growth standpoint, from a contribution standpoint, from the organic growth, we think there's big opportunity there. We've increased the margin contribution pretty substantially in the last 2 quarters without growth. And so that organic growth would translate into more margin contribution.

What was the second part?

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

The buyback, maybe I'll take that one, the capital strategy. So we pulled the dividends earlier this year when the pandemic hit to conserve cash and make sure we didn't have any issue on the debt front. It was always odd that we, as a software company, had a dividend. I think we were very unique on that front. So I wouldn't expect the dividend to come back. I do think that there's the potential that we would look at returning capital to shareholders, but probably in a different manner than a recurring dividend, probably more so through buybacks or onetime type dividends.

As you guys know and saw, we just recently renegotiated our debt facility and expanded and extended that in advance of that kind of date that was coming up in June of next year to take advantage of very favorable market conditions. So we've got good availability and liquidity and borrowing capacity, which is critical for our capital structure. We increased the share buyback capacity twofold for 2 reasons: one, to more closely match the size of that buyback program with the current size of the company and our capital structure today.

So that buyback has been in place, the $50 million that was authorized was here when I got here 10 years ago. And we had never updated that, so we resized that to fit the current size of the business, which is substantially larger than it was and also our cash flow generation ability to date versus where it was previously. But also increased it to have the availability and authorization to go into the market and buy back our stock when we believe that we have the capital to do it and that the stock in its value is underappreciated by the market, which today, at its current price, we believe it is.

So there's a good chance that we will be in the market in the future, if the stock doesn't rebound well, because we believe it's well undervalued compared to peers, especially in light of what we believe this company is able to do over the next few years with our increased focus on profitability and cash flow generation.

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**Operator**

Our next question comes from Matthew VanVliet with BTIG.

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

This is all very helpful. I guess as you think about how the margin levels kind of fluctuate here over the next couple of years? Are there any major sort of internal development projects that could either are contemplated or could impact where you're spending on the R&D side?



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And then on the second sort of separate question. You sort of touched on the framework of M&A. But just curious if you're putting more weight on accretive immediately on the margin side, or if it's still trying to check all the boxes as possible?

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

Yes, sure. So thanks, Matt. This is Mike. From an R&D standpoint, we're, in fact, in hiring mode pretty aggressively in R&D. You probably just go to our website, there is a bunch of jobs open there. So we're going to be pretty aggressive there driving a couple of things. Innovation and some things that are coming out from a product portfolio standpoint, but also driving this loop from our data centers to predominantly Azure, some AWS, or predominantly Azure, and it's now become a lower cost environment for us to get there.

So we've made some changes in our infrastructure and our tech stack, if you will, with more to come, but the move to Azure will take cost out. And we're -- it's not only less for us now to run there, but we're also sort of eating duplicate costs that we want to get rid of. So there is margin opportunity there from an R&D standpoint, to make that data center swap to your specific question. So we're pretty aggressively doing that.

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

And then I think on the M&A front, Matt, with where we are and with this increased focus on profitability and cash flow with a little bit pivot that direction. When I think about M&A, I don't know that it would preclude us from looking for true growth story. But I do think we would tend to lean more in this environment towards something that's more accretive on the profit and cash flow side of things with the synergies, but I don't think it precludes us from doing a straight growth kind of acquisition, but certainly would put more emphasis on those that are going to be able to generate good quality margins and cash flow.

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

It needs to be a good portfolio fit, obviously, for us as well. So a lot what happens sometimes with these acquisitions is our distribution channel gives us scale for these smaller tuck-in acquisitions. So it drives growth as well.

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**Operator**

Our next question comes from Kirk Materne with Evercore.

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

Thanks for the additional detail in the presentation. I guess, just from a portfolio perspective, Mike, are you good with where you are right now? Meaning, are there any products that are maybe smaller or less meaningful in nature that you could look to rationalize -- that you could look to rationalize or maybe divest. I was just -- it seems like you've done some of that already, but I was just kind of curious if there's more to come on that front?

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

Yes, sure. We've actually sunset about 24 products in the last 5 years. Most recently, we did sunset a product. We had a product called everydayhero. The acquisition of JustGiving a couple of years ago, a part of that was to move those customers to JustGiving, we just completed that. So that product essentially just sunsetted. There's more of that to do in the portfolio, but it's less than it was 3, 4 years ago because the larger legacy platforms have already been sunset and the customers moved the go-forward platform. So I would think of that in terms of there's some of that's left, but it's not really meaningful from a financial standpoint. So there's some of that left, but not a lot.



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**Operator**

Our next question comes from the line MacDonald with Needham & Company.

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

Mike, as we look at the progression from the near-term targets to the midterm targets over the next few years, you talked that you'd expect a really a quick recovery in some of the usage-based events post pandemic. How should we compare that to the expected recovery in the core software business in terms of new bookings? You've clearly made a lot of investments in sort of driving digital lead generation. Does that maybe compress that time as we think about the next 2 to 3 years versus 3 to 4?

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

Yes. I think bookings will come back, a little different by the different markets we serve. So the first part of your question is the transaction and usage, that should just turn on like a switch. Because the customers are still on the platform. They're just not running their event. So we don't have to sell them, implement them, get them live. They're already locked, they've using our platform for years. So when they start having events, the revenue comes back. That's instantaneous, if you will.

On the booking side, we're having really good success in areas like small to medium nonprofits right now. Bookings are fantastic there. In some areas like with performing art centers and museums, they're still fairly closed. So bookings are slow there. So it's a little bit different by vertical. If you roll it all up to the macro, bookings are not where we want them to be this year. And so there's going to be a longer tail, obviously, on bookings than usage and transactions, which will just turn on like a light switch. So we expect the bookings to come back. It's going to be coming back differently by vertical market.

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

Yes. And Ryan, I think the key on that, when you're looking at the revenue growth, versus the bookings is just to keep in mind the time frame as the bookings ramp back up. So as soon we get vaccine and some kind of herd immunity next year, and we can start having mass participation events and our customer base feels better about where they are and the zoos and museums and universities, everybody are back open, full scale, I expect to see pipeline and bookings improve.

But it's going to take time for those to flow through implementation and into revenue. And so that's why there's a little longer time frame there for that top line revenue growth to pick back up, as Mike said, transactions will be very quick to turn back on. Bookings will take 12 to 18 months to flow through to the revenue side, depending on how quickly the pipeline refills and we close deals.

**Operator**

Our next question comes from Rishi Jaluria with D.A. Davidson.

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

Appreciate all the detail. Just 2 quick ones. Just first, in terms of the breakdown, how should we be thinking about the gross margin difference between these maybe even directionally?



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And then Rule of 40 is, I think, really helpful. Just how do we think about going forward cash conversion from EBITDA to cash flow and even if we think just operating cash flow and assume CapEx pretty consistent at somewhere around 5% of revenue? Then just maybe just given EBITDA to operating cash flow would be helpful.

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

Yes, Rishi, this is Tony. Those two are actually really closely tied. On the gross margin side, as we've spoken about, the real wildcard is the core BBMS payments business because that has a much lower margin structure, as you're aware. So depending on where that mix is, that throws things up. But let's assume kind of steady mix. We'd expect gross margins to improve over the next few years. In the near term, it's going to be tough. As Mike said, we're pumping more dollars into the engineering team and our [ECO] team to get us moved out of our colo data centers and into a third-party provider data centers. We get some nice security benefits, a lot of services, availability and scale.

And so what we'll see is as we move out of those data centers into third party cloud, we'll see efficiency in our COGS area of the business, the cost of hosting that will improve our gross margins. I would expect also that we will see our dollar amount of cap software plateau over the next couple of years. And as that amortization amount catches up, then we should start seeing some leverage in COGS and gross margins on that front as well over the next few years. So that will help.

And then we're always looking to drive efficiencies and other pieces and parts of the business. And I think we've got an opportunity in some of the other areas of COGS to gain some efficiencies over the next few years as well. So I would expect gross margins to improve as a result of cost of goods decreasing, all things held constant on mix.

On the Rule of 40 and cash conversion cycle, obviously, profitability, as you can see in the goals -- the aspirational goals we've set out, profitability is indicated there that it's going to increase fairly significantly. That increase in profitability should drop-through to cash flow. So I'd expect free cash flow margins and operating cash flow margins to improve.

And then secondarily, because we are exiting so many of these facilities and changing our workforce strategy as most companies are, we will have less CapEx related to facilities in the future. And then secondarily, as we get out of all these colo data centers, we will have a lot less CapEx, because we will not be purchasing hardware and equipment to host all of our products on -- for our customers. And so I'd expect to see CapEx drop off over the next few years as well, which that will juice free cash flow margins also over that same time period.

So I think all of those point positively to improvements on the rule of fording from a profit perspective as well as improving free cash flow margins at the same time.

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**Operator**

Thank you. And I'm going to show no further questions at this time. I'd like to turn the call back over to Mike Gianoni for closing remarks.

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

Thanks, operator. Thanks, everyone. I'll just close by saying that hopefully, today has been helpful in providing additional clarity into our expectations for performance during the pandemic and longer term. We listen to all of you. Just wanted to provide more information. We believe that the steady execution against the Rule of 40 financial framework and our continued commitment to disciplined capital deployment will generate substantial shareholder value. And we look forward to providing a more comprehensive update on our initiatives to accelerate long-term performance at an investors' session early next year. Thanks, everyone.

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**Operator**

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

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