Second Quarter 2024
Earnings Call Transcript

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CONFERENCE CALL PARTICIPANTS

Jonathan Bass, *Stephens Inc.*

Kenneth Lee, *RBC Capital Markets*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Cannae Holdings, Inc. Second Quarter 2024 Financial Results Conference Call.

During today's presentation, all parties will be in a listen-only mode. Following the Company's prepared remarks, the conference will be open for questions, with instructions to follow at that time.

As a reminder, this conference call is being recorded and a replay is available through 11:59 p.m. Eastern Time on August 15, 2024.

With that, I would like to turn the call over to Jamie Lillis of Solebury Strategic Communications. Please go ahead.

Jamie Lillis

Thank you, Operator, and all of you for joining us.

On the call today, we have Ryan Caswell, Cannae's President, and Bryan Coy, our Chief Financial Officer.

Before we begin, I would like to remind listeners that this conference call and the Q&A following our remarks may contain forward-looking statements that involve a number of risks and uncertainties. Statements that are not historical facts, including statements about Cannae's expectations, hopes, intentions or strategies regarding the future are forward-looking statements. Forward-looking statements are based on Management's beliefs, as well as assumptions made by, and information currently available to, Management. Because such statements are based on expectations as to future financial and operating results and are not statements of fact, actual results may differ materially from those projected. The Company undertakes no obligation to update any forward-looking statements, whether as a result of new information, future events, or otherwise. The risks and uncertainties which forward-looking statements are subject to include, but are not limited to, the risks and other factors detailed in our quarterly shareholder letter, which was released this afternoon, and in our other filings with the SEC.

Today's remarks will also include references to non-GAAP financial measures. Additional information, including a reconciliation between non-GAAP financial information to the GAAP financial information, is provided in our shareholder letter.

I would now like to turn the call over to Ryan.

Ryan Caswell

Thank you, Jamie.

Good afternoon, everyone, and thank you for joining us on our second quarter conference call.

First off, I want to note that Bill is unable to join the call today, as he is traveling. He will be back on the call next quarter.

Consistent with past earnings calls, we will provide some high-level commentary on strategy and key events during the second quarter, before turning to a more detailed discussion of some of our portfolio companies, and finish with some financial details.

We continue to focus on executing our strategic plan, designed to grow both the net asset value, or NAV, of our portfolio while also working to close our share price discount to NAV. Our strategy has three main levers, including: improving the performance and valuation of our portfolio companies; making new investments, primarily in private businesses that will produce cash flows and grow NAV; and providing capital returns to our shareholders through either our recently introduced cash dividend or share repurchases. We believe the combination of these three strategic pillars will close the value gap between our stock price and NAV.

We remain optimistic about our portfolio companies and have spent considerable time this quarter working with the Management Teams of each to enact strategic transactions, improve operations and drive additional cash flow.

For example, Alight was able to close on the sale of their Payroll and Professional Services businesses for up to $1.2 billion of consideration. This required significant time and effort from Alight's Management Team and Board, and we appreciate all of the work from each to get such an instrumental transaction over the line.

With regards to D&B, Bill and the D&B Board continue to work with the Management Team to drive revenue growth, improve free cash flow conversion, and consider strategic transactions which we believe will drive shareholder value.

We also spent considerable time this quarter with the Management Team of the Restaurant Group and Minden Mill, focused on refining their strategic plans with regards to sales targets and optimizing their respective expense bases, which we believe will maximize cash flow and increase their valuation and Cannae's NAV.

Unfortunately, not all of our portfolio companies performed to expectation, and during the second quarter, we took a $141 million impairment on the book value of our Sightline investment. Sightline has been unable to get the expected market adoption on its key products and while Management remains optimistic about the future, we believe that given the results to date and cash position of the company, we were required to impair our investment.

Moving on to our investment pipeline, we continue to look for new, attractive investment opportunities that we believe will increase our NAV. We are primarily focused on platform investments in the private markets. As stated before, we plan to fund any new acquisition through redeploying capital from the sale of some of our public company investments.

I would now like to provide a bit more detail on our partnership to date with JANA Partners and resulting potential investment opportunities.

Since the announcement in Q1, we spent considerable time with the team at JANA looking for undervalued public companies where there is a specific catalyst to unlock value and Cannae can participate in that catalyst as an acquirer or capital solution. Cannae's participation, and as a potential capital source, provides JANA an additional tool to push for change at the target company, while at the same time creating potential investment opportunities for Cannae. In certain situations, Cannae may take a position in the target company stock as we see how the process plays out and if there are any potential large or capital investment opportunities.

In Q2, we made our first investment alongside JANA. While I don't want to discuss the specifics of that situation given its public nature, we remain optimistic that our partnership with JANA will produce attractive acquisition opportunities for Cannae.

I would now like to discuss capital returns to shareholders.

On September 30, we will be paying our second dividend of $0.12 per share. We also bought back 300,000 shares in the second quarter, following the 9.7 million shares we bought back in our tender in Q1, bringing our year-to-date purchases to 10 million shares. Between the dividend and share buybacks, we have returned over $235 million of capital to our shareholders in 2024.

Turning to our portfolio companies, our largest holding, Dun & Bradstreet, reported second quarter revenue of $576 million, representing 4.3% year-over-year organic growth, which is an acceleration, as compared to 3.9% organic growth in the prior year second quarter, and the fourth consecutive quarter of mid-single-digit growth. The company generated 5.7% growth in Adjusted EBITDA in the second quarter, which equated to $218 million at a 37.8% margin, up 60 basis points as compared to the year ago second quarter. Leverage at D&B today has moved down to 3.7 times, and Management expects to be at 3.5 times by the end of this year.

On Monday, D&B issued a statement acknowledging that it has received inbound interest from third parties and has retained advisors to assist with those enquiries. We will not make any comments on this matter going forward.

Our second largest holding, Alight, announced Tuesday that Stephan Scholl will step down as CEO and a member of the Board, effective after the Board names a successor. We wanted to thank Stephan for his commitment and vision, and for the impact he has made as CEO.

Post closing of the sale of the previously referenced payroll and professional services business, Alight used $740 million of the proceeds to repay debt, bringing Alight's net leverage down to 2.8 times. The company repurchased $80 million of Alight shares in the second quarter, and announced at $75 million accelerated share repurchase mid-June, leaving $93 million of share buyback authorization. We believe this transaction is a positive for Alight and that the remaining business is a simpler public equity story that will have more recurring revenue, with higher EBITDA margins. This is evidenced by Management's comments that they already have 97% of its 2024 revenue under contract, and the company forecast a second half 2024 Adjusted EBITDA margin range between 25% and 26% for the full year, and reaffirmed a mid-term Adjusted EBITDA margin target of 28%.

Looking at Alight's second quarter results, which exclude discontinued operations, the Company generated $538 million of revenue from continuing operations in the 2024 quarter, down 4% from the $561 million in the prior year. Second quarter 2024 Adjusted EBITDA from continuing operations was $105 million, representing a 19.5% margin, compared to $119 million, or a 21.2% margin, in the 2023 quarter.

Turning to Black Knight Football. In our first full year of ownership at AFC Bournemouth, the team finished in 12th place in the Premier League Table and earned 48 points, the most the Cherries have earned in a Premier League season. This success is also translating to revenue growth for AFC Bournemouth, as revenue for the 12 months ended June 30, 2024, grew to approximately $203 million, a 19% increase from the $170 million in the corresponding period ended June 30, 2023. The uptick was primarily driven by improvements of more than 40% in both sponsorship and hospitality revenue, as well as higher Premier League income from Bournemouth's higher placement in the Table. Looking forward, we continue to see positive momentum, both from the commercial and sporting perspective.

At FC Lorient, where we own 40%, the club finished in 17th place and was relegated to Ligue 2 for the upcoming season. While we are frustrated with the result, we believe the team has the resources and talent to quickly return to Ligue 1. Furthermore, our put collar arrangement to buy the remaining stake of FC Lorient contemplated this potential scenario and our valuation for the remaining stake is reduced while the team is in Ligue 2.

Hibernian FC, which we have a 25% interest, finished the season in 8th place, out of 12 clubs, in the Scottish Premiership League.

We continue to also build out the BKFC holding company, given our belief that an interconnected, multi-club ownership model can best deliver improved sporting outcomes, create better player pathways, enhance fan and community experiences, and improve commercial revenues and profitability across the group.

As part of that strategy, in June, we announced that Tim Bezbatchenko has been hired as BKFC's first President. Prior to BKFC, Tim enjoyed tremendous success in leadership roles within Major League Soccer. Tim will work with our portfolio clubs to standardize and improve player recruiting and development, enhance player pathways, and optimize commercial opportunities across the group.

Lastly, I would like to provide a few updates on Minden Mill and the Restaurant Group, given the work during the previous quarter.

We continue to make progress at Minden Mill, and it released its first product, an ultra-premium vodka, called High Ground Vodka, which was well received by the market. The distillery is on track for a fourth quarter release of Minden Mill bourbon, rye and American single-malt whiskey brands from inventory acquired in the May 2023 acquisition and has already begun a more scaled development of additional brown liquors that require four-plus years of aging.

Moving on to the Restaurant Group, following the strategic reduction in store locations discussed last quarter, we have continued with our realignment and are reducing corporate overhead. This quarter, we laid off approximately 20% of the corporate employees and are in the process of reducing third-party spending and downsizing the Group's headquarters. Our work has already produced positive results, as second quarter 2024 Adjusted EBITDA was more than twice that of the prior year second quarter. Our Management Team is focused on improving cash flow and increasing the guest counts at our locations, which is key to long-term profitability at the store and corporate levels.

We believe the actions at both Minden Mill and the Restaurant Group will improve cash flows and increase their respective values.

I will now turn the call over to Bryan.

Bryan Coy

Thanks, Ryan.

I'll briefly cover the P&L, balance sheet and liquidity.

Second quarter 2024 operating revenues were down $35 million, or 23%, compared to the prior year quarter, reflecting a 27% reduction in the number of restaurant locations year-over-year. Same store sales on the remaining locations were down slightly, with lower guest counts offset by higher average checks.

Cost of restaurant revenues fell at a greater pace than revenues, dropping to 85.6% of restaurant revenues in the second quarter of 2024, compared to 88.4% in the second quarter of '23, a 280-basis-point improvement resulting from the reduction of four-wall, or onsite, costs.

The remainder of operating expenses comprise personnel costs, depreciation, and other operating expenses. These expenses, which include the restaurant and the real estate businesses, as well as Cannae corporate, increased $4.8 million in the aggregate, or approximately 11% quarter-over-quarter. The drivers for this increase include an ISIP bonus related to sales of Dayforce shares during the 2024 quarter, notably on which Cannae realized a $27 million gain over the pre-IPO basis, as well as higher stock comp and termination fees. These were offset by significant decreases in the Restaurant Group impairments and expenses, as well as reduction in professional fees at the Cannae corporate level.

Recognized losses of $145 million in the second quarter reflect a non-cash impairment charge to the book value of Sightline, while decreased losses from equity method investments relate to the prior year write-down of System1.

I'll also give you a little bit more detail on the impairment of Sightline and the rational behind it. The lack of traction with their legacy products, combined with investments in completing development of a new product, caused further pressure on their operational results and liquidity through the second quarter. In light of continued negative cash flows from operations, uncertainty in future financial and operational forecasts, and a challenged liquidity position, we had a valuation of the company prepared and, based on those results, we recorded an impairment charge to the book value of our investment. With that said, we're hopeful the company begins to see better results, and we'll continue to work with Sightline Management Team.

Cannae's balance sheet and liquidity position remain solid.

Since March 31, we've sold 1 million shares of Dayforce for gross proceeds of $57 million. We're now down to 500,000 shares remaining out of the 37.1 million shares we held at Dayforce's IPO. We'll use this capital for new investments, investments in the growth of our existing portfolio, as well as capital returns to our shareholders.

Cannae has approximately $29 million in corporate cash today, and has nothing drawn on its margin loan, leaving $150 million of immediate capacity on that facility. The only outstanding debt presently is $60 million under the term note that matures near the end of 2025. Cannae also, notably, has $1.3 billion of marketable securities that could be utilized for future liquidity.

At close today, Cannae's aggregate NAV was $2.1 billion, or $32.90 per Cannae share, compared to today's closing price of $19.95.

With that, I'll now turn the call back to the Operator to begin our Q&A session.

Operator

Thank you. At this time, if you would like to ask a question, please press the star and one on your telephone keypad. You may remove yourself from the queue at any time by pressing star and two. We'll pause for a moment to allow questions to queue.

We will take our first question from John Campbell with Stephens.

Jonathan Bass

Hey, guys. It's Jonathan Bass on for John. Thanks for taking my questions. I know you can't comment directly on the D&B take-out rumors, so I'd love to hear just at a high level a refresh on your investment thesis for D&B, and why you guys view the valuation so steeply discounted here. Thanks.

Ryan Caswell

So, I guess the thesis when we made the investment, or kind of how we view valuation today? Is that—what are you trying to get at? I apologize.

Jonathan Bass

Yes, that's right, just what your thesis was when you got into D&B and maybe just your thesis, if you could.

Ryan Caswell

Thanks for the clarification. When we initially invested in the business, we thought it was an undervalued business that had kind of great data assets, great market penetration, and we believed that there was some obvious cost savings that we could enact in the business, as well as we could invest in product to improve the revenue growth.

We think we have done a lot of it. We think Anthony and the team have done a lot of those things, if you look at the growth in the EBITDA since our deal, as well as kind of they've turned what was—at the time of the acquisition was kind of a flat revenue business to 4.3% organic growth. With that all being said, we're frustrated where the business is, where the business trades, but we think the team is on the right path and they're doing the right things to create additional value at D&B.

Jonathan Bass

Got it, thanks. Then, turning to Bournemouth here, they had a really nice season, finishing at the mid-level of the Table, which is a solid improvement from the prior year, and it seems like your guys' strategy is playing out nicely there, so I want to touch on two things here. One, could you just speak to the level of investment you guys expect over the course of the next year, and as the club looks at starting its new season here shortly; and then maybe after that, at this point, given what the club has done, would you guys consider taking some ownership off the table?

Ryan Caswell

On the first question, we're still in the middle of the transfer window, so kind of the exact capital needs for the club, given the importance of buying and selling players, we need to determine kind of the exact squad makeup before, I think, we have a real view of kind of the capital needs or the capital position of the club will be, so I think we'll have to hold off on that. I do think at Bournemouth, there will be some of that amount of investment over the season, but what that is, we're still trying to figure out, based on what happens over the next month of the window.

Then, in terms of taking ownership off the table, I don't think in the near term we are looking to do that. Unless, obviously, if someone came up and offered us an incredible price, we would think about it, but we think there are a lot more changes, there are a lot more things that we can do at Bournemouth, and Black Knight Football more broadly, to create shareholder value.

Jonathan Bass

Got it. Thank you, guys.

Operator

Thank you. We will take our next question from Ian Zaffino with Oppenheimer.

Ian Zaffino

Thank you very much. Maybe on Alight here. Like you've said, Management change, you've got the payroll sales. Is a potential strategic sale of this still something you might consider? I guess the way I think about is, if you look at the D&B news and then you look at this, maybe to take that money and then with that capital, do what you please. Any thoughts there? Thanks.

Ryan Caswell

I'll answer that in two ways. In terms of a specific sale, or something like that, I mean, I don't—it's a public company, obviously, there's a price out there every day for it, so if people are interested, obviously, they can come talk to them.

But, in terms of how we think about capital allocation more broadly, I would say that we clearly—as we mentioned in some of the prepared remarks, as we think about new investments, we have to reallocate capital from some of our public company investments into those investments, or into returns of capital to shareholders. Clearly, Dun & Bradstreet and Alight are some of the biggest positions. So, just kind of depending on the cadence, and when that is, we'll have to think about kind of all the different things that are going on as we think about allocating that capital.

Ian Zaffino

Okay, thank you, and then, I guess, the other follow-up would be on capital allocation. You're buying stock, but is there a read into that as far as maybe there might not be as many opportunities, or how do you kind of prioritize buying stock versus returning capital to shareholders? Thanks.

Ryan Caswell

Look, I think we've returned quite a bit of capital to shareholders over the first two quarters, between the tender and the dividend. I think we like just doing a dividend, because it's consistent capital that's returned to shareholders every quarter, and obviously, in the first quarter, we bought back about 9.7 million shares, which is a big chunk for us, so we're letting that kind of, I'll say, settle out and see kind of where we are. But we believe that the strategy that closes the discount is both a combination of capital returns to shareholders, including share buybacks, as well as basically investments that are growing NAV, and we believe those are most likely private company investments, where we can reallocate some of the capital from the public companies into those.

I don't have a specific view on the allocation, it's more of, I think, we look at on a case-by-case basis as we have investments and as we look at kind of where our stock is trading, and we make a decision on how we want to allocate that capital, but we believe it's a combination of both of those things.

Ian Zaffino

Okay, thank you very much.

Ryan Caswell

Thank you.

Operator

Thank you. Once again, if you would like to ask a question, please press the star and one on your telephone keypad now.

We will take our next question from Kenneth Lee with RBC Capital Markets.

Kenneth Lee

Hey, good afternoon, and thanks for taking my question, just one follow-up on the previous question there, and perhaps just to put a finer point on it. I realize you can't talk to much about the D&B strategic view, but if there was a potentially sizeable monetization of your public portfolio holdings, at this point, would you lean towards returning the bulk of that excess cash towards repurchases or allocating towards newer investments, just given the current environment? Thanks.

Ryan Caswell

Look, I think we'd have to think about that when something actually comes up and kind of what is going on, but, in general, we believe it's a combination of both, of the share buybacks and the dividend, as well as kind of investments in businesses. So, what the percentage allocation is, and all that, we'd have to think about that when the situation comes up, but it's a combination of those two things.

Kenneth Lee

Got you, okay. Then, for my follow-up, and this one is about the JANA partnership here, more broadly, in the context of the partnership, what's sort of like the playbook here, what could we expect in terms of a potential transaction or investment going forward? I realize you can't talk too much about the Rapid7 investment, but is it sort of like we could see a potential co-investment, where Cannae makes an investment in equity along with some other investment firms? I just want to get a better sense of how future investments or transactions could emerge there. Thanks.

Ryan Caswell

Look, I think it's—I mean, you understand our capital base. It kind of depends on the size of the business that we're looking at, what that business needs, whether it's—you know, ideally, it would be an acquisition opportunity, but could it be another capital solution, and then, depending on the size, we would look to partner with different firms, similar to what we've done with D&B, or other take-privates of businesses in the past. So, again, how the exact the playbook and how it plays out is a bit TBD, given the early stage of the partnership, but it's relying on the skills of JANA to enact change and utilizing Cannae as a capital source in a potential acquisition partner to find attractive investments.

Kenneth Lee

Okay, got you, and just one last quick one, if I may, and this is in regards to the impairment charge you took for Sightline in the quarter there. In terms of the specifics driving the impairment, it sounded as if there was, if I got it right, a lack of progress in terms of development of a new product.

Was there any kind of changing industry conditions, or anything that changed in terms of potential adoption by the industry, that also drove the impairment? I just want to get a better understanding there. Thanks.

Bryan Coy

I can take that one, Ryan, if you want. It's a little bit backwards, Ken. It's more of some of their legacy products were not getting the traction that they wanted while they're developing—they've got a new product in development, as well, but the combination of those two put quite a bit of pressure on them as far as cash flow from operations and profitability in the short run.

Kenneth Lee

Got you, okay, helpful there, helpful. I think that's it. Thank you very much.

Ryan Caswell

Thanks, Ken.

Bryan Coy

Thank you, Ken.

Operator

Thank you, and it appears that we have no further questions at this time. I will now turn the call back to Ryan Caswell for closing remarks.

Ryan Caswell

Thank you, Operator.

To conclude, we have taken significant steps through the first six months of the year to position Cannae for success, which we believe will lead to NAV growth and narrowing our share price discount. We remain confident that we are on the right path and are excited with the opportunities that we have in front of us to create value for our shareholders.

Thank you again for your time today.

Operator

Thank you. This does conclude today's Cannae Holdings Second Quarter 2024 Earnings Call. Thank you for your participation. You may disconnect at any time.