Third Quarter 2023
Earnings Call Transcript

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CORPORATE PARTICIPANTS

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Bryan Coy, *Chief Financial Officer*

Ryan Caswell, *President*

CONFERENCE CALL PARTICIPANTS

Ian Zaffino, *Oppenheimer*

Kenneth Lee, *RBC Capital Markets*

John Campbell, *Stephens, Inc.*

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Cannae Holdings Inc. Third Quarter 2023 Financial Results Conference Call.

As a reminder, this conference call is being recorded, and a replay is available through 11:59 p.m. Eastern Time on November 14, 2023.

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

Jamie Lillis

Thank you, Operator, and all of you for joining us this afternoon. On the call today, we have our Chief Executive Officer, Rick Massey; Cannae's President, Ryan Caswell; 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 with the GAAP financial information is provided in our shareholder letter.

I would now like to turn the call over to Cannae's CEO, Rick Massey.

Rick Massey

Thanks, Jamie, and thanks, everyone, for joining us on our third quarter conference call. As Jamie mentioned, Bryan Coy, our CFO, and Ryan Caswell, our President, are both here with me.

I want to remind you that we filed online two things; one of which is our shareholder letter, which we filed about half an hour ago. That's got a much more detailed discussion of our various portfolio companies, cash position, etc. And, secondly, we dutifully filed our Sum of the Parts, which essentially is our net asset value per investment and then broken down on a per Cannae share basis. We do that on a monthly basis.

I recommend you check in on those, you'll get really more than I can tell you on this short phone call. So I'll be brief since all that information is out there in the public. We still believe that our own stock is our best investment with our precious capital. As you may have noted from our shareholder letter, our buyback authority was replenished by our Board a couple of weeks ago. And so, we have over—well over 10 million shares of authority. We bought back 2.7 million shares in the third quarter, which turns out to be about roughly 4% of the Company in that three-month period of time.

And since we started our little journey on buybacks, we bought back almost a quarter of the Company with about $0.5 billion. And, we have no reason to discontinue that operation. As I said, based on what we see out there, we don't see anything better than buying back our own stock. It's hard to turn down a double essentially on liquidation value.

I'll just mention three portfolio companies in alphabetical order. Alight had a really, really good quarter, 8.4% revenue growth which excited the market. The 26% BPaaS growth, that's their sort of comprehensive enterprise offering that is really selling well and providing increasing margins to Alight. For those of you who are cash flow nerds like me, the most promising and encouraging news out of Alight was that they grew their EBITDA margin by about 175 basis points to nearly 20%, which is really good. And, in my opinion, they blew it out on cash flow. Their cash flow was a multiple of cash flow over the corresponding quarter. So, they're finally getting the benefit of this restructuring that they're doing and the automation that's embedded within the movement of employees from call centers to mobile.

Stephan mentioned on his earnings call, in the Q&A, that they're handling hundreds of thousands more, maybe a million more, employees during this enrollment period and yet the number of calls and the number of call center people is flat. Their mobile uptake has tripled over last year's enrollment period. This is right up on the plan. You're starting to see the benefits of automation. The Company's humming. The stock is way depressed, not for any reason other than the fact that there is a lot of PE overhang. And when that certain private equity firm is sold, since they've sold it, they've really crashed the stock afterwards.

We don't know where they are. They've gone off the board. They don't report their ownership anymore. They're below 10%. But we are certainly hoping that we see some excess volume there. So, we're hoping that that's then moving out of the stock and maybe they'll be out shortly.

D&B is another one that's woefully undervalued. This morning I did the math. They're trading at about a 40% discount to peer multiples despite the fact that they're growing in line with peers. And revenue-wise, they grew 5.8% on a before FX basis over third quarter of 2022. And their margin expanded a little bit, and they are able to delever a little bit. So, they do have a little bit too much leverage. We ought to be thinking about strategies to reduce that and Alight had a little bit too much leverage. We're thinking about trying to come up with some strategies to help delever those businesses that we think will help. At least it will give them some buyback power.

Ceridian, as usual, just knocked it out of the park for the third quarter. I'll just note that UBS, I just was handed a report, picked up both. Kevin McVeigh, who was covering Alight at CS moved to UBS and just initiated on Alight and Ceridian, $10 price target on Alight and an $87 price target on Ceridian. So obviously, pretty bullish on those.

I'm going to turn it over to Bryan to talk about a handful of things.

Bryan Coy

Sure. I wanted to briefly demonstrate the discount in our net asset value. We started the year with an aggregate net asset value of $2.7 billion, which was about a 43% discount compared to where our stock was at the time. We were trading at $20.65. And, as of today, we're still at a $2.3 billion aggregate net asset value against our stock price of $17.80. So, that comes out to $31.79 intrinsic value per Cannae shares or a 44% discount. The discount has remained rather steady. It's why we have been dutifully continuing to buy our shares down month after month after month. You'll notice a little bit of a decrease in that aggregate fair value, reflecting some of that we've sold off another 20% of our Ceridian shares.

We've taken a couple of hits on fair marks: System1, Dunn & Bradstreet, Alight, Ceridian. All those are fair valued every month and therein tied to the stock price. This month, in particular, we took a further write-down for book on System1, reflecting the market's opinion of the stock at the time. And we also took a rather large mark on Sightline. I'll talk about that one briefly.

We discussed on our second quarter earnings call that Sightline has had a lot of challenges lately like ease and sign up for the app, acceptance rates from processors. Their product rollout has definitely been slower than anticipated, as has acceptance and rollout to other major strip operators. All those have factored into a lot of their challenges, and in late Q3, we further questioned their plans and timing. As a result, we engaged a third-party firm to prepare a valuation of Sightline. That resulting valuation range was well below Cannae's recorded book value as well as the fair value mark from a third-party investment from late 2022.

Accordingly, we recorded about a $70 million impairment to its book value and reduced the fair value by another $157 million on a Sum of the Parts. So, the fact that we're still holding at $2.3 billion and a 44% discount has been pretty steady and validates us continuing to buy our own stock.

Ryan?

Ryan Caswell

Yes. I'll just quickly touch on Black Knight football. We've continued to make good progress over the quarter and year-to-date. Commercial revenues are up about 30% year-over-year, which shows what Jim and some of the new hires have been doing to both increase the sponsorship, increase hospitality, increase ticketing. That's positive. We also invested in some players as well as re-signed some of our top players to keep the kind of the contract value and the financial value of those players over time. Lastly, we did raise a little bit of capital for Black Knight. Cannae contributed about $25 million. We had third parties in for the remainder. We raised a little over $60 million in the quarter.

Rick Massey

With that, Operator, we'll turn it over to questions.

Operator

The first question comes from Ian Zaffino of Oppenheimer. Please go ahead.

Ian Zaffino

Hi. Thank you very much. Great detail.

So, I wanted to ask you as far as just kind of philosophy here of the Company. Are we going to see new investments on the horizon? Or what are your thoughts on current investments? Maybe selling down DNB, given kind of how big it is in your portfolio? And, at what point does it maybe make sense to just kind of collapse the structure here instead of buying back shares? How about just return everything to shareholders?

Rick Massey

Okay. Great questions. I'll see if I can deal with those generally. As I've said, we're not actively looking, nor have we been shown any interesting investments. We're not actively looking for investments. We are on a path to buy back our shares within the limits provided by the law. And yes, you could say that it would be stupid and probably not even legal for us to telegraph what we're going to do with our publicly traded portfolio companies and our ownership there. But there are shares that we own that are so far below our basis that will never catch up. And those would make really nice tax harvesting structure offsets as well as giving us some cash to do more buybacks. So, I'll let you go do the math on our portfolio. But I don't think I should get in much more detail about that.

As to the collapsing of the structure and so forth, it's very tax inefficient to do it that way, and there's a couple of reasons for that. The main reason being that if we buy back more than a certain number of shares then we lose the availability of our capital loss carryforwards and carrybacks. And so theoretically, we could take some capital losses today and reach back to prior periods. And we're thinking about this, reach back to prior periods and get a refund for taxes that we paid in prior years. If we were to have bought back over a three-year period, a control of the Company, then the availability of those carry forwards are—they're not going to be available, they'll be severely limited. We are a C-corp. So, those losses are important to avoiding sort of a double tax on distribution of assets.

We can't go a lot faster than we're going and preserve these very valuable tax assets. So, except over time, our ability to buy is volume limited. Our daily volume can increase as we buy back more. And, it sort of snowballs and we'll be able to accelerate our buybacks as we continue to do this. I think it's 25% of our average daily trading volume. Our average daily trading volume is about 425,000 shares-ish and over time we plan on it creeping up. Does any of that make sense? We've had quite a few people come and say, why don't you just liquidate the thing and distribute the proceeds? Well, that's taxable to you. That's the main reason. And it would be taxable to us if we liquidate something for a gain. We at least would like to not have a gain on the C-Corp side. Hopefully, that makes sense.

Ian Zaffino

Yes. And then as far as maybe even raising more cash for even more buybacks, how do you think about O'Charley's and 99?

Rick Massey

Well, bring us a bid. We would love for Oppenheimer to be in the restaurant business, Ian. I don't mean to be cute about it. 99 is an okay restaurant chain. O'Charley's drinks cash. We're in a workout sort of mode to get down to a small number of restaurants that are going to generate cash. And we're going to sell all our fee property if we haven't already sold it, get out of a bunch of leases. If you look around, there's not a lot of M&A going on in restaurants, and consumer discretionary in general. We'd love to get a bid. We've actually entertained a few, got a little bit down the road. There have been a couple of kind of roll-up, I don't know if you call it—they're just very acquisitive companies out there buying brands but they're not doing it anymore. Look, we tried to sell our System1, but there's not a market in it. We're looking for cash in every possible spot.

Ian Zaffino

Okay. I guess there's just one more. We're talking about O'Charley's. What kind of EBITDA do you think that could eventually generate?

Rick Massey

Post restructuring, what would that be?

Ian Zaffino

Yes, post restructuring.

Bryan Coy

Post restructuring, the combined restaurant group can do $15 million, $20 million a year annualized after you've gotten out of all these negative cash flow.

Rick Massey

That includes 99?

Bryan Coy

Yes, that includes 99. That's the whole group. Including a couple of one-offs for 99, they've closed almost 80 stores in the last year, and most of them were the negative cash flow ones. So, they've done a lot of work rationalizing that to get out of the real stinkers. And then get that into the ones that are performing better.

Ian Zaffino

All right, perfect. Thank you very much. I appreciate that.

Rick Massey

Thank you, Ian. Good questions.

Operator

The next question comes from Kenneth Lee of RBC Capital Markets.

Kenneth Lee

Hi. How's everyone doing? Thanks for taking my question. In terms of the book value impairment for System1. Could you just get into a little further detail in terms of what that was based on? What was just simply based on the share price trading below a certain level? Just wanted to see what triggered that.

Bryan Coy

Sure. Ken, this is Bryan. It was a prolonged market value below where our recorded book value was. We usually will take down our equity method investment by the amount of their losses each quarter, but the market actually put a lower value on it than we had even in losses. So we mark all of our public ones effectively. If they get below our book value for an extended period of time, we end up taking a non-cash impairment charge to bring them down to the aggregate market value of our investments.

Rick Massey

We did that with Paysafe.

Bryan Coy

Yes. We did that with Paysafe, a couple of times in the past as well.

Kenneth Lee

Very helpful there. And then in terms of the private investment valuations, as you look across the rest of the portfolio, and it looks as if you did some third-party valuation for the Sightline investment. How do you think about the rest of the private investments and their valuations?

Bryan Coy

I don't think there's anything in there that we're not comfortable with, Ken. The numbers are not very big, as you can tell by the Sum of the Parts. I think the cost and value of everything else is sitting in the $50 million range, and that's made up of about half a dozen or so smaller investments. The only other one we have talked about like Minden Mill was $50 million. We just got into that one.

Rick Massey

We paid a third of liquidation value for Minden. It was sort of an exception to that we don't see a better deal out there because it was just such a screaming purchase. And CSI is an $84 million investment.

We're not in the lead on that. It's doing well, growing about 8% or 9% top line. Expanding margins, doing all the stuff you'd expect a Frank Martire run company to do, that's going to do fine. But there's no liquidity event for that. We just bought it a year and a half ago.

Kenneth Lee

Very helpful there. And then just one follow-up. I think in the prepared remarks, you briefly mentioned that there was a $25 million capital raise for BKFC where Cannae participated. Could you just talk a little bit more about what the capital raise was for and the potential longer-term outlook for there?

Bryan Coy

Yes. So, we raised about $62 million for BKFC, about $25 million of that was Cannae. There were some incremental opportunities to acquire some players as well as some opportunistic capital. So, we brought in Ryan Sports Ventures, who's an institutional investor that owns other teams and other sports properties. And, we think they can be helpful as a longer-term partner. So, this was—so it's a bit—we got some additional players that we weren't—that I'd say kind of were a little bit outside of where we thought, as well as we wanted opportunistic capital for the business going forward.

Kenneth Lee

And if I could just follow up on that one. Remind me again, for AFC Bournemouth, when it comes to the transfer budget, is the source of the funding capital from BKFC? I just wanted to get a little bit more details around that.

Bryan Coy

It's a mix of basically being funded with the operating revenues of the business. Then in certain instances, we may put in additional capital to try and fund incremental or additional players. So, it's kind of a mix. I think going forward, we hope that it will all be funded internally as we start to sell some players. But today, it's kind of a mix of revenue from the business as well as kind of what I'll call holdco capital.

Kenneth Lee
Got you. Very helpful there. Thanks again.

Rick Massey

Thank you, Ken, Good questions.

Operator

Our next question will come from John Campbell of Stephens Inc. Please go ahead.

John Campbell

Rick, thanks for all the details on the buybacks. It sounds like you guys have definitely done all of your homework and you know exactly what you can and can't do. So, no more questions there for us. We'll leave it at buybacks just basically continue to be a major focus for you guys. I think it's probably a fair statement.

Rick Massey

Let me just say, at some point, our volume limits are going to permit us to buy back. Let me just do some rough math, and I'm not making promises. But if we were to buy back or a maximum, which would be roughly 200,000 shares a day, 20 million, say, 200 trading days a year, which is probably a little high. Let's call it, 20 million shares. That gets you down to 50 million and continuing down our buybacks, you're going to buy back maybe 10% a quarter if you keep those volume levels up. Ian asked earlier, can you go faster? If we keep going down this path, we're going to go faster.

John Campbell

Right. Makes a lot of sense. I remember the commentary at your Investor Day 2 years ago, you'd buy it back to the last share. It sounds like you guys are kind of living up to that for sure. But on Bournemouth, just looking at the season thus far, I'm curious if you guys are starting to see the benefits from any of the operational improvements you guys have put in place? And Ryan, I know you talked to the overall BKFS revenues being up 30%. Maybe if you could isolate Bournemouth maybe in terms of, I don't know what the key metrics are, if it's revenue per match, average attendance, sponsorships, whatever you guys kind of look at? How are those metrics trending for you guys?

Ryan Caswell

I think on the business side and the commercial side, we've done really well. As we've talked about before, we're a bit constrained by just the overall stadium. But, Jim and the team have done a great job of increasing - I'd say the three things, that there is ticketing, there's what I'll call hospitality, and then there's basically kind of broader sponsorship in commercial. And, so, in each of those categories we're up a good amount. The ticketing we’re up probably north of 10%. And that's just on price increases. On hospitality, I would guess we're probably up close to 40% there. That's a combination of both price increases as well as converting parts of the stadiums that were non-revenue generating areas to revenue generating areas. And in sponsorship, we're up a similar amount. And that's really from both pushing price on the existing sponsors as well as basically going out and finding new sponsors. They've changed the model around. How they're looking at the regional sponsors versus more of national or international sponsors and where they're getting signage within the stadium.

The team has done a really good job around all of that. We're very happy there. We feel good about that part of the business, and we hope the on-field performance follows suit.

John Campbell

Okay. That's helpful. And then you're kind of balancing—you're almost tipping the line on a majority of investment there, 48% now. Moving forward, I don't know if you guys have pinned or pegged out kind of an investment cycle or if you're looking to inject further capital over the next couple of years, but are you guys assuming that you'll continue to have a minority position any time you raise from here you'll do it alongside others, and you'll kind of keep that minority position?

Rick Massey

No, we're not planning on retaining this percentage necessarily. It's not hardcoded. And we're not sure there'd be any more need for capital. We went into this with sort of a five to seven year investment horizon. So, we're still pretty early on in it. But our theory was that we would run it, we would get it, we would improve it, we'd run it and we'd sell it.

John Campbell

Okay, that's very helpful. Keep up the good work. Thanks guys.

Rick Massey

Thanks John. Good questions.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Rick Massey for any closing remarks.

Rick Massey

Thanks a lot for joining our call. You're all welcome to set up a side call with Bryan, Ryan, me, any of the above in the subsequent days. We have quite a few calls lined up, but we could always take a few more. Feel free to reach out to us. Thanks for your interest in Cannae Holdings.