Stagwell Q3 2024 Earnings Call

Thursday, 7th November 2024

Introduction

Ben Allanson

Investor Relations Lead, Stagwell

Good morning. From Stagwell global headquarters in One World Trade Center, New York. Welcome to Stagwell Inc's earnings webcast for the third quarter of 2024. My name is Ben Allanson, and I lead the Investor Relations function here at Stagwell. With me today are Mark Penn, Stagwell chairman and chief executive officer, and Frank Lanuto, the chief financial officer. Mark will provide a business update, and Frank will share a financial review. After the prepared remarks, we will open the floor for Q&A. You are welcome to submit questions through the chat function.

Before we begin, I'd like to remind you that the following remarks include forward looking statements and non-GAAP financial data. Forward looking statements about the company, including those related to earnings guidance, are subject to uncertainties and risk factors addressed in our earnings release, slide presentation and the company's SEC filings. Please refer to our website, StagwellGlobal.com/investors, for an investor presentation and additional resources. This morning's press release and slide deck provide definitions, explanations, and reconciliations of non-GAAP financial data. And with that, I'd like to turn the call over to our chairman and CEO, Mark Penn.

Business Update

Mark Penn

Chairman & CEO, Stagwell

Thank you, Ben, and thank you to everyone joining us on our earnings call. I am pleased to report a strong quarter that reflects growth in all five of our principal capabilities. Underlying this growth is that the new, larger contracts we won are only now coming online, though some even starting Q4. And we are seeing particularly strong growth in digital transformation as AI projects are coming in, the Stagwell marketing cloud is gaining traction as it launches its new products and platforms. In addition, we're experiencing a strong advocacy season, which will also peak in Q4.

The third quarter results show us returning to industry leading growth. We believe we are poised to deliver double digit growth in the fourth quarter and will be well positioned for 2025. We are reaffirming our full year guidance today after a more moderated start to the year. We are accelerating into the back half. Our new business momentum continued as we won our single largest deal to date with a global tech company and have expanded our work with major tech companies this quarter by 30%. Our tech company relationships have come back strongly. We posted a net new business figure of $101 million, bringing our LTM new business to $345 million, another company record. This was driven by a new business pipeline, and increasingly larger global pitches.

And I want to thank our team, led by our CMO, Ryan Linder and his team, for helping manage a great new business process. The total number of wins increased 32% year over year, while the average size of our wins above $1 million increased to 74%. A top 25 customer with Stagwell is now approximately a $25 million a year relationship as we continue to scale the company's full-service capabilities. Turning to the basic numbers, we achieved $711 million of revenue, or 15% growth, in the third quarter. This growth is led by 85% growth in advocacy, 25% in digital transformation, and 30% growth in the Stagwell marketing cloud. We generated $580 million of net revenue, representing 8.5% total growth and 8% organic growth year over year, the best in the industry.

Our adjusted EBITDA came in at $111 million in 3Q, even as we continued to invest $18 million of OpEx this quarter in growing our cloud and AI based software solutions. Stagwell is a tech company's tech company. We are working to develop applications, re-imagine consumer interfaces and deliver marketing solutions for the AI businesses of almost every Faang company. One cannot underestimate the workflow that will be required to make AI usable by consumers, and the role our code and theory network will play in bringing that about for tech and not tech companies. While we have seen the digital transformation businesses of others falter, we are experiencing the opposite here and have strengthened our capabilities by bringing together all our digital transformation resources into a single network.

The Code and Theory Network just won Ad Age's 2024 Business Transformation Agency of the Year Award, recognizing its outstanding work to help businesses get ready for the AI era. For example, we're at the forefront of applying AI to helping voters understand politics. We designed and built the magic walls used on election night at both CNN and NBC. Our recent redesign of the Real Clear Polling site incorporates an AI bot that will answer complex questions on polling information not just with text, but also with graphical information, which is a breakthrough in AI to consumer communication. You can learn more about the work we are doing with AI at www.Stagwell.AI.

The Stagwell Marketing Cloud group has shown strong growth in the third quarter as well, growing 30% year over year to $74 million. SMC grew 26% net revenue terms to $59 million, representing 23% organic net revenue growth. Key elements of this growth are the early July addition of BERA.AI, a research tool that lets marketers and financial analysts compute the value of brand reputation and track it in the marketplace. Marketers can wargame and justify their expenditures on brand marketing with a sophisticated tool by using it to predict the enhanced value of marketing expenditures. BERA is part of a recently inked $15 million, five-year AI deal with a major payments company in 15 countries.

Another SMC product, Wonder Cave, our best-in-class AI powered text messaging platform, has been successfully leveraged by more than 500 political and advocacy organizations throughout the political season. More than four billion text messages have been sent during this cycle to support these organizations fundraising, voter contact, and get out the vote efforts. Wonder cave is also branching out from its political origins and helping brands with their customer engagement. From February to September this year, the number of messages sent by non-advocacy brands increased by more than 500%.

Around our augmented reality experience for stadiums and sports broadcasts continues to gain traction as it held an unprecedented event with the L.A. Rams bringing a fantasy experience to fans that was sponsored by Uber Eats and Princess Cruises. We're continuing to strengthen the global nature of our network to achieve more scaled global assignments. We acquired Consulum, a well-known government relations agency based in MENA, and are actively working with them to expand our presence in the region. I am recently back from a successful trip there and I believe we can achieve significant expansion in the air. We also expanded assembly enforcement and bodenfors in the region and now have in total nearly 500 people there. The regions revenue grew 128% year over year in the third quarter, and has grown 88% year to date. We expect this kind of growth to repeat itself next year.

Other steps we have taken include the acquisition of leaders in Israeli social influencer and engagement, agency and platform. It expands our social content creation capabilities and upgrades our influencer marketing platform offerings. Our advocacy businesses continue to perform extremely well. With the momentum continuing past the end of the quarter to Election Day. Advocacy revenue grew 85% year over year in the third quarter. With the election outcome, we expect that public affairs and issue advocacy campaigns will surge in 2025 given legislative opportunities and the entire sector will continue to grow as 2028 will likely be the biggest election in history given the need for primaries on both sides.

Other key elements of our strategy that we're in the process of writing for next year include established ID graph used to centralize all our data and information to better target consumers. We're also building what we call the machine, a fully integrated AI based content development platform built in conjunction with Adobe. We believe this will be the backbone of our technological differentiation in the new world of AI based content. We expect this to be ready in the next six months. In addition to the wins now coming online, our pipeline is at record levels, up 30% over the previous year. And we're participating in multiple large pitches right now. We are also seeing more work being awarded without pitches from major clients, indicating a good environment for our work and the marketplace generally.

As Frank will detail, we continue to hold the line on expenses, keeping our comp to revenue expense at about 61% this quarter. We continue to see our stock as undervalued given our enhanced industry position, solid growth and good cost management, and have continued our buyback program, expanding it by another $125 million. Our industry leading growth is a reflection. We believe in the strategy we have pursued in combining the right balance of creativity and technology that will be needed in the AI era. This is reflected in our winning both new global creative assignments and cutting-edge technology deployment assignments. At the same time, wisely pursued business in key developing segments like advocacy that will continue to grow over time and stadium experiences that are simply nascent. This is what makes us increasingly attractive to large brands as the challenger marketing and technology company. Now I'll hand things over to Frank Lanuto, our chief financial officer, to walk you through some of our financial results in more detail.

Financial Review

Frank Lanuto

Chief Financial Officer, Stagwell

Thank you, Mark. Good morning, everyone, and thank you for joining us to discuss our third quarter results. As a reminder, if you would like to ask a question after the prepared remarks conclude, please feel free to submit them through the chat function. Stagwell delivered solid third quarter financial results with growth in all five of our principal capabilities. For the quarter, we reported revenue of $711 million, an increase of 15% as compared to the same period in the prior year, and net revenue of $580 million, an increase of 8% over the prior period.

Turning to revenue by capability, all five principal capabilities grew in Q3. Growth in digital transformation accelerated during the quarter, increasing to $163 million, a 25% improvement over the prior period, while advocacy grew 59%. Growth x advocacy also increased 16%, partially powered by AI driven activities and digital transformation. Stagwell Marketing Cloud posted $74 million in revenue, an increase of 30% year over year, driven by significant growth in Wonder Cave, as well as strength among our travel, healthcare, and retail customers.

Consumer Insights and Strategy reported $47 million in revenue, an increase of 7% as compared to the comparable period last year. This was partially driven by the rebound in Hollywood based, media focused research, as well as increased project size and new business among technology, gaming, communications and automotive clients. Performance media and data delivered $80 million in revenue, an increase of 9% over the prior year period. The growth was driven by continued strength in the consumer products and business services sectors and was further supported by a recent return to growth in technology. And creativity and communications delivered $334 million in revenue, an increase of 11% over the prior period. These results were driven by growth among clients in the retail, technology and consumer sectors, as well as by strength in our advocacy businesses.

Moving to operating expenses, we continue to improve margins through effective cost management. Personnel staffing costs, excluding incentives, are the single largest expense declined as a percentage of net revenue by 179 basis points to 60.9% versus the prior period. We also made progress with G&A expenses. Continued real estate consolidation into centrally located regional hubs helped to reduce such costs by approximately 8% year over year. Our shared services initiative also contributed to annualized cost savings of approximately $10 million through reductions in accounting, IT and HR as we continue to centralize such functions. These savings were partially offset by increased direct unbillable expenses and other OpEx related to higher revenues and client servicing activities. As a result, Stagwell delivered $111 million in adjusted EBITDA in the third quarter, with a related margin of 19.2% on net revenue, an improvement of approximately 15 basis points over the prior period. Excluding our cloud investment of $18 million this quarter, our third quarter adjusted EBITDA margin would have been approximately 22.2%.

Moving to the balance sheet, we continue to focus on capital allocation to maintain a strong financial position. We reduced the balance of deferred acquisition consideration by approximately $72 million, down to $62 million from the end of the third quarter last year. We remain on track to reduce our DAC obligations to approximately $40 million by the end of 2024, excluding recently completed acquisitions. We also reduced NCI balances by approximately $7 million from the end of the third quarter of 2023, down to $23 million. These reductions to DAC and NCI will be accretive to net income and EPs in future periods. During the quarter, we acquired approximately two million shares at an average price of $6.60 per share for approximately $13 dollars. This brings our year to date repurchases to 13.8 million shares at an average price of $6.29, or approximately $87 million.

Our buyback authorization as of quarter end had approximately $52 million in remaining availability. As noted in our press release on November 7th, the board authorized an extension and the $125 million increase in the size of our previously approved stock repurchase program. As amended, we may now buy back up to an aggregate of $375 million in class A common stock. Capex and capitalized software for the quarter was $5 million, broadly in line with our targets. Cash flows from operations for the nine months year to date improved by $58 million relative to the same period a year ago, driven principally by improvements in our working capital management. And year to date, we accelerated our M&A activity relative to last year.

Through the first three quarters of 2024, we completed seven acquisitions versus two last year. We acquired approximately six times as much revenue in the current year, while simultaneously deploying a comparatively smaller, four times as much cash as we continue to make accretive acquisitions that produce strong returns. We continue to evaluate our portfolio and also explore potential dispositions. As a result, we ended the quarter with $146 million in cash and drawings under our revolver of $375 million, resulting in a leverage ratio of 3.5 times.

And finally, we are affirming our full year 2024 guidance as follows. Organic net revenue growth is expected to be between 5 to 7%. Organic net revenue, excluding advocacy growth, is expected to be 4 to 5%. Adjusted EBITDA is expected to be between $400 million to $450 million. We expect to deliver approximately 50% free cash flow conversion, and adjusted earnings per share is expected to be between $0.75 and $0.88. That concludes our prepared remarks for this morning. I will now turn the call back over to Ben to open the Q&A portion of the call.

Q&A

Ben Allanson: Thank you, Frank. Just a reminder, if you have any questions, please do submit them via the chat button at the top of the screen. Lots of questions today about digital transformation, and so we'll kick it off with a question from Steve Cahill over at Wells Fargo. PTE improved nicely in the quarter. Can you help maybe to unpack some of the improvement there, and do you view this as kind of a sustainable inflection point moving forward?

Mark Penn: I do view it as a sustainable inflection point because I think as I've been saying, I was coming and the work that people needed to do and AI was coming. And I think what we're seeing is that it's beginning to arrive. I think it's arriving really first at the many tech clients who are clients of ours, who have to build the interfaces to make to make AI accessible to consumers. And then I think that's going to spread to the clients, who then have to make their own individual websites and contact points accessible through AI. So, as I've said, I think there's many years of digital transformation to come here. We were in - we went from that year of efficiency to what I said is going to be the year of competition. And I said that, look, they build the chips, they have the clouds, and then they're going to get to the applications. And I think that now they're getting to the applications.

Ben Allanson: So a lot of other questions about SMC, which obviously had some really nice growth in the quarter as well. A question here from Jason Kreyer at Craig-Hallum, it goes SMC is seeing consistent acceleration across 2024. Can you maybe talk a little bit about what some of the key solutions resonating with clients today are and what may be some of the levers that we might have to sort of drive greater monetization across the SMC suite over the coming years?

Mark Penn: Well, I think that we're seeing pick up on some of the advanced media platforms. I think we saw some increase in kind of advertising on some of the screens. We've seen really kind of I highlighted what we saw in terms of the around product because you can see big name sponsors are now coming on. So it's a combination of big teams, big sponsors, new experiences. I think that we're still in the nascent phase of the initial sponsors are getting really positive feedback from the experiences and that can grow over the next couple of years to a very significant business.

And we appear to be ahead of the curve in terms of other technologies that are out there that produce that kind of augmented reality experience. I think that we're particularly enthusiastic about the product. It is a truly sophisticated, not just brand tracking tool, but a brand modeling and economic analysis tool that CMOs can use to answer the question that CEOs always ask, why should I spend any money on this? And I think it is an incredible suite of tools. And we've already seen pickup across the major payments company. We've seen people really want to sign on for a long period.

Mark Penn: It's getting really positive feedback. Over the long run, we know we're going to have communications products. And those have been bolstered by the particularly the leader's platform. As an influencer platform that we're seeing also has good pickup of our research products, with Quest and BERA and the brand terminal that are already in 150 clients. And our Wonder Cave platform also is a remarkably efficient platform for delivering targeted text message marketing. We also believe that we're ahead of the curve here. We also had the experience of developing it through the political season, which means that we have so much more experience targeting through text messaging in virtually any platform out there because of the billions of messages and the data that we've been able to build up through those messages.

So I think the cloud is a really exciting place. I think it's one of the unique features that makes us a challenger marketing company. The big ones really don't have this kind of incubation of tech products across these different areas, and the ability to develop them and implement them as quickly as we are. And I think you're seeing promise. I hope that answers your question. I'm always happy to follow up on this one.

Ben Allanson: Maybe just riffing off that a little bit. Laura Martin over at Needham, she asked some questions about the Gen AI roadmap, and then she kind of goes, and this is a question a lot of investors have over the next three years say, do you think that Gen AI innovations will lower cost more or drive revenue upside? It's kind of your take.

Mark Penn: I think for us, there's no question that will drive revenue that because we're not just in the business of delivering marketing, but in the business of delivering to digital transformation. That is going to be there were websites, there were apps. Now there's going to be AI based connections between companies and consumers. I think you saw Elon Musk unveil robots. There will be home pods. There will be various ways that brands now communicate to large language models with consumers in new ways. And it opens up, I think, a whole new sphere of digital transformation. So that's why for us, I expect it to be a core revenue driver. I expect that obviously there are internal uses of AI, like better production and creating new images and storyboards and making ads with less production money.

It will still take the same creativity to make it, even more advanced creativity to make it a differentiated ad. It will primarily benefit the production process, which is 90% pass through expenses for us anyway. So lower cost of production will only generate more and interesting creative, high level work. It's the same thing that I saw how the survey business as it transferred to more online work still has incredible work for the skilled professionals, they're involved.

So I think that's the internal use. We're on it. We're deploying it and research. We're deploying it in in terms of image production, I think it's going to be helpful, but it doesn't take revenue away. And I think in the long run it does the opposite. It takes a lot of the real drudge work and a lot of the pass-through revenues away. But the real benefit for us is being in the digital transformation areas where we help the companies market AI on the marketing side, and most importantly, develop AI interfaces to consumers, because that's the way brands are really going to move their image.

Ben Allanson: Question from Mark Zgutowicz over at Benchmark. And this is looking at government services, something we've kind of talked about that over time. And obviously, Consulum acquisition, which has a significant government portion as well. Can you maybe talk about how you're viewing the vision for that part of the business, maybe over the next three to five years?

Mark Penn: Sure. I think that about 10 to 15% of our business should be government related. I think because of the history of a lot of our firms were originally smaller firms or were not part of a larger unit, they really didn't go after government business. In the last two months over at Code and Theory, they have developed a government services unit. We're developing one for all of the marketing services. We're beginning to learn all of what we need to do for the financial aspects of the of the complicated proposals. I want that to go from the zero it is now to the 10 or 15% of our business that it can be, but do I see that as a six-month process? No. Realistically, it's going to take two or three years to win a couple of major ones. But we are really well positioned to gain that kind of work. And we now have the kind of infrastructure that the government will look for to get us awarded that kind of work.

Ben Allanson: Let's change gears a little bit, talk a little bit about new business wins. And Jeff Van Sinderen over at B. Riley, he's asked, can you speak just a little bit more about some of these recent wins and a little bit about kind of revenue ramp from some of those wins as well, when we expect to see some of those start flowing through. Is this a 2025 thing, a second half of this year, how are you thinking about it?

Mark Penn: Sure, I think some of the tech company ones remain undisclosed. I think you've seen us announce major wins with Adobe. Major wins with GM in terms of both Chevy and Cadillac. I think you've seen a pretty good win in Ferrara. I think that those the Adobe stuff really comes on in December, and some of the GM has started in the kind of second half of the third quarter. All of these things will, I think, come through full year in the next year. And I expect that these wins will all be started before the end of the year. And as I say, we have a surprising number of 10 to $20 million pitches out that we're waiting on decisions on that would start next year.

Ben Allanson: Good stuff. I think kind of playing off that a little bit. Cameron McVey has asked, when you think of a given CMO pitch, how have their priorities shifted, if at all? Like what seems to be that most important capability to win new business currently for Stagwell?

Mark Penn: I think that the number one more CMOs are interested in us as the challenger. I think our visibility as an alternative coming out of CAN[?] and with our team and I recently was a keynote speaker at the ANA to a couple of thousand marketers. Just in general, I think our visibility and establishment as a credible alternative to the top majors has really come up significantly. And I can see that in the pitch flow that we're getting. In terms of an individual CMO it will vary by industry, by product. Is it a luxury industry, a car industry? Is it a more creative interested CMO? Is it a more performance marketing one? I don't think there's any single silver bullet there.

Mark Penn: What I can say is that, if you look at RFPs and how business is solicited, I think people look at marketing services, which is creative and content research and all of those things. And we are really well-skilled, and we have really incredible creative names at the top; 72andSunny, Anomaly, Forsman, Doner. All of them are incredible award-winning groups backed by award winning research, now backed by award winning social content creation with movers and shakers and leaders. And I think the second path is media that CMOs put out quite separately media and data RFPs. And that's where Assembly and Gail are both now top names. And again, as we scale those up, we go to we go to bigger clients across more countries. And then the third is digital transformation. And I combined all the digital transformation companies to scale that up. So what we're showing across these three verticals is increased scale, award winning professionalism and a mix of creativity and digital talent that can both design and build these experiences.

Ben Allanson: Good stuff. Just a reminder. Any final questions? Please do throw them into the chat. I think just the last one to kind of key in on a little bit here. Well, maybe two more. But first of all, and I want to make sure we're obviously not putting out forward guidance today. I want to make sure everyone is aware of that. But one of the questions we've got is about maybe the growth algorithm moving forward as we look into the end of 2024 and then over the course of the next few years, as you think about the growth drivers and the growth algorithms Stagwell, what does that look like?

Mark Penn: Well, we've always said that the most important thing for our growth is the health of digital transformation, because that should be the highest growth service. And I think we went through a period here with the year of efficiency and the tech pullbacks, which is over. And now I think we're getting back to that in the long term. We're seeing very nice growth in the creative services which some people would think it's a surprise, but I think it's some of the majors have moved out of creative. In fact, our creative services have become more valuable.

I think media is a kind of a constant growth area for us that we're going to add significant data and other resources to that to be increasingly competitive in bigger pictures. And obviously, the marketing cloud over the long run should go with digital transformation and achieve very high growth rates. Once I think all the products are developed. So I don't know if I fully answered, but our growth algorithm was always that the digital services would grow at the faster rates, the creative services would grow at kind of lower single digit rates, and kind of research and media somewhere in between.

Ben Allanson: Good stuff. I think that brings us to the end of the questions for today and to the end of the third quarter call. Thank you so much for everyone for joining us, and we look forward to welcoming you for the Q4 call in the New Year.

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