

## **Q3 2012 EARNINGS CONFERENCE CALL**

**October 26, 2012**

### **Kathy Guinnesssey**

Good morning, everyone, and thank you for joining us today.

With me on the call this morning are:

- Sara Mathew, our Chairman and Chief Executive Officer
- Rich Veldran, our Chief Financial Officer
- Byron Vielehr, our President of North America
- Manny Conti, our President of International, and
- Josh Peirez, our President of Global Product, Marketing and Innovation

Here is what you can expect on today's call. First, Sara will begin with a brief review of the third quarter and an update on MaxCV. Then Rich will follow with a detailed discussion of our results, with an emphasis on North America.

After that, the team will be available to take your questions. To manage the time and ensure we get to all callers, we ask that you limit yourself to 3 questions. You can then go back into the queue if you have follow-ups.

To help our analysts and investors understand how we view the business, our remarks this morning will include forward-looking statements.

Our Form 10-K and 10-Q filings – as well as the earnings release we issued yesterday – highlight a number of important risk factors that could cause our actual results to differ from these forward-looking statements.

These documents are available on the Investor Relations section of our Web site, and we encourage you to review this material. We undertake no obligation to update any forward-looking statements.

During our call today, we will be discussing a number of non-GAAP financial measures, as that's how we manage the business. For example, when we discuss "revenue growth" we'll be referring to the non-GAAP measure "core revenue growth before the effect of foreign exchange," unless otherwise noted. When we discuss "operating income," "operating margin" and "EPS," these will all be on a non-GAAP basis, before non-core gains and charges.

A reconciliation between these and other non-GAAP financial measures and the most directly comparable GAAP measure can be found in the schedules to our earnings release.

They can also be found in a supplemental reconciliation schedule that we post on the Investor Relations section of our Web site.

Later today, you'll also find a transcript of this call on our Investor Relations site. With that, I'll now turn the call over to Sara Mathew. Sara?

## Sara Mathew

Thank you Kathy and good morning everyone. Yesterday we reported our third quarter results

- Core Revenue was up 2%;
- Operating Income was up 8%;
- EPS was up 24%; and
- We delivered year-to-date free cash flow of \$255 million.

Overall, we are pleased with these results as both North America and International performed **better** than expected. North America benefitted from timing of a large deal that moved from the fourth quarter into the third quarter. And, International saw strength in value added solutions despite the weak economy in Europe. So, in summary, the year is unfolding as expected and in a moment, Rich will discuss the quarter in more detail.

With 2012 mostly behind us, we are starting to look ahead. As a team, we are not satisfied with our top line performance, so we are focusing our efforts on better positioning ourselves for sustainable long term growth.

During the upcoming quarter, there will be 3 areas of investment

1. Data-as-a-service or DaaS solutions,
2. Foundational data and advanced analytics for large companies, and
3. The B2B Portal, which is currently in test.

Let me touch on each of these, beginning with DaaS.

As we shared with you previously, DaaS represents a very large opportunity for D&B and we are still developing in the market. DaaS allows D&B to expand its footprint, as customers can easily embed D&B data directly into their workflows. Earlier this year, Salesforce.com began selling D&B data on their CRM platform, and in Q3, Salesforce generated about half of our DaaS revenue, which in total represented 2 points of growth in the S&MS segment.

Based on the success of the Salesforce partnership, we are pursuing additional distribution channels to drive growth. Next up is Microsoft's Value Added Reseller network to sell D&B 360 directly to Microsoft's CRM customers. Demand for D&B data embedded in customer workflows remains high and we continue to expect DaaS to be a major growth driver in the years ahead.

Our second area of focus includes foundational investments in new data sources, and innovative approaches in the way we analyze commercial activity. We call this "Big insight", as we are leveraging "big data" within D&B and our customer base to create a step change in the level of insight we bring to market. We are early in the development of these capabilities and see opportunities in the areas of customer prospecting, fraud, supply chain transparency and global compliance.

As just one example, we are now in market with a new compliance solution - D&B Compliance Check, to help customers understand their third party relationships, and comply with government regulations around the world.

By combining D&B company data with other third party sources, and using our matching and analytical capabilities to drive proprietary insight, we signed our first multi-million dollar deal with a Fortune 50 company in the 3rd quarter. This solution is foundational to their global compliance program to effectively manage risk across their enterprise.

Since then, several other global customers have expressed interest in the product, and we see demand in the marketplace for D&B led compliance solutions around the world.

Our final area of investment will be in our new on-line trade portal, which is currently in a test in China. The B2B portal is an excellent example of the innovation you can expect from D&B in the years ahead.

The portal leverages our global database and takes our matching capabilities beyond just company specific information, to the products companies purchase and sell. This is a unique value proposition, as it allows Chinese suppliers to find and connect with US buyers, who are interested in the products they sell.

Existing players in this space typically offer on-line directories where suppliers can list and advertise their products, but there is limited insight to help them find the most relevant buyers. Early reaction from customers has been favorable, and we are trending ahead of expectations after the first few weeks in market.

We will closely watch customer adoption patterns in the fourth quarter, before investing to accelerate growth. Of note, we were able to respond very quickly to these emerging customer needs I shared with you today, due to the capabilities enabled by MaxCV.

Let me close with a discussion on MaxCV. We are on track to be up and running with the new data supply chain in one market by year end. The build was completed in August and all of the component testing was finished during the third quarter. In the fourth quarter, we expect to complete the user acceptance testing, so we can migrate our products and customers over to the new infrastructure.

At that point, the physical build out of the new data supply chain will be behind us, and as previously communicated, all expenses incurred to connect the US and other MaxCV markets to the new supply chain will be included in our core operating expenses. We are in the midst of our annual planning process and will be able to give you more color on these costs when we provide our guidance for next year.

So with that, let me turn the call over to Rich Veldran, to review our third quarter results in more detail. Rich?

## **Rich Veldran**

Thank you Sara and good morning everyone.

This morning I'm going to walk through our third quarter results and provide you with some color on our outlook for the remainder of the year.

Let me start with revenue. Total company core revenue was \$413 million, up 2% from last year, and slightly ahead of our expectations. North America, which represents about 75% of the total, was up 1% and International grew 5%; of which 3 points was organic.

As expected, after declining 2% during the first half of the year, North America's trajectory improved during Q3, helped in part by a timing benefit from Q4. Specifically, one point of growth came from a large government contract that last year signed in the fourth quarter. Overall, our revenue expectations for North America are unchanged at about flat for 2012. The improved revenue, coupled with the large Compliance check sale that Sara referenced in her comments has resulted in deferred revenue being up about 1% for the quarter.

Turning to our solution sets, Risk Management, or RMS was down 2% in the third quarter. During the quarter, we continued to face the same pressures we have seen all year, although results were helped by the timing shift.

The majority of the RMS decline in the quarter was due to continuing pressure on Non-DNBI subscription revenue. Budget constraints led customers to continue to “trade down” from data subscriptions to smaller usage based plans.

Total DNBI was down 1%, in line with expectations, with retention in the low 90% range and mid-single digit price lifts on renewals.

Similar to Q2, 1% growth in our core DNBI product was not enough to offset double-digit declines in revenue from DNBI modules. DNBI modules provide additional functionality to the core DNBI platform and represent about 10% of total DNBI revenue. With the exception of DNBI PRM, we have not upgraded our modules in the past few years as we moved DNBI development to Ireland. With customer budgets under pressure, some customers are choosing to stay with the core DNBI product to handle their risk management needs, and this has been putting pressure on our module sales over the last 9 months.

Our newest module, PRM was introduced late last year, and we missed the 2012 budget cycle for renewal. We are beginning to see a pick-up in sales of PRM and expect it to improve as we enter the annual renewal season in Q4 and Q1.

Turning to Sales & Marketing, revenue increased 10% during the quarter driven by strong growth in our value added solutions. Traditional S&MS was down 4% in the quarter, an improvement from the double digit decline posted last quarter. Revenue in traditional S&MS can be volatile quarter to quarter as the total revenue is small and large contracts have a significant impact on quarterly results.

The robust 16% growth in value added solutions was largely driven by the continued strength of Optimizer and traction in our DaaS products that contributed about 2 points to total S&MS growth in the quarter.

Lastly, Internet Solutions, our smallest segment, was down 3% during the quarter, due to tight customer spending and competitive pressures. Most of the revenue is subscription and we can see that the negative revenue trend will likely worsen over the next several quarters, and this is factored into our guidance for the year.

Looking ahead, we continue to expect North America revenue to be about flat for the full year. Given the timing benefit to the third quarter results, the Q4 revenue is likely to be about flat.

Turning to International, which represents 25% of company revenue, total core revenue increased 5% during the third quarter, slightly ahead of expectations. Organic revenue grew 3%.

Our Europe & Other segment, which represented 57% of total international revenue, grew 3% during the quarter. Continued penetration of DNBi across our owned markets, as well as strong cross border demand are helping us grow despite the difficult macroeconomic environment.

Moving to Asia Pacific, which represented 43% of total International, revenue grew 9% during the quarter. This strong performance was driven by 3 key factors:

1. continued organic growth in Australia.
2. The benefit from the reorganization of Japan into a partnership earlier in the year, that provides a lift to our cross border revenue, and
3. the acquisition of MicroMarketing in China at the end of last year which contributed 6 points of inorganic growth to Asia Pacific results.

International is on track to post mid-single digit growth for the full year.

Let me now discuss our overall profitability during the quarter. Total company operating income was up 8% in the third quarter, which was better than our going-in expectations. North America income was up 5%, including growth from the timing benefit from revenue which I discussed earlier, as well as the benefits of our reengineering program. International operating income was up 16%, due to the benefits of reengineering and the positive impact from the recent restructuring of our Japan operation where we exited the domestic market and retained the high margin cross border business.

Looking ahead to the fourth quarter, as Sara mentioned earlier, we expect to increase the level of investments in both North America and International behind DaaS, Data and analytics and the B2B portal. As a result, we expect total operating income to be up in low single digits in the fourth quarter.

Diluted EPS was up 24% during the third quarter. This strong performance reflects the higher operating income, plus 11 points of accretion from share repurchases and 6 points from a lower tax rate in the quarter. Year to date we have repurchased \$236 million of shares under our discretionary share repurchase program at an average price of \$69.29 per share. That leaves \$734 million left under our current discretionary authorization, which we expect to complete over the next 2 years.

Our tax rate was 32.5% in the third quarter, which was lower than prior quarters due to the close out of prior year open audits in the third quarter. We expect our full year tax rate to be approximately 33%.

Finally, year-to-date we generated \$255 million of free cash flow, compared to \$231 million during the same period last year.

I'll now turn the call back to Sara.

## **Sara Mathew**

Thank you, Rich.

So in summary, the year is unfolding as we expected, and we are on track to deliver our full year guidance. Specifically:

- Revenue growth of 0% to 3%
- Operating income growth of 4% to 7%
- EPS at the high end of the range of 8% to 11%, and
- Free cash flow between \$275 to \$305 million

Looking ahead, we are focused on three areas of investment– DaaS, Foundational data and advanced analytics and the B2B portal, all of which offer exciting opportunities for sustainable growth.

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Let me close by congratulating Byron and Manny on their new responsibilities. As we announced yesterday, Byron will become President of International and Global Operations and Manny Conti will become President of North America. Both Byron and Manny have deep and broad expertise across the company, and this rotation is designed to continue to grow and develop both these leaders.

Manny and Byron will be transitioning their responsibilities during the fourth quarter, so we close 2012 and start 2013 with minimal disruption

And with that we would like to open the call for your questions. Operator ?

## **AFTER Q&A**

Let me close with a brief message to the D&B team, many of whom are on the call today. Congratulations on a solid Q3. Your dedication and commitment is greatly appreciated.

And, to our investors on the call, thank you for your time, if there are additional questions, please feel free to give us a call once we sign off.

Thank you. Operator