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VeriSign, Inc.'s (VRSN) CEO James Bidzos on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

[Press Release](#)[SEC 10-Q](#)[Slides](#)

EPS of \$1.36 beats by \$0.05 | Revenue of \$308.42M (0.86% Y/Y) beats by \$0.09M

Earning Call Audio



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VeriSign, Inc. (NASDAQ:VRSN) Q3 2019 Results Earnings Conference Call October 24, 2019 4:30 PM ET

Company Participants

David Atchley - VP of IR & Corporate Treasurer

James Bidzos - President and Chief Executive Officer

Todd Strubbe - Executive Vice President and Chief Operating Officer

George Kilguss - Executive Vice President and Chief Financial Officer

Conference Call Participants

Matt Lemenager - Robert W. Baird Equity Research

Sterling Auty - JPMorgan

Nicolas Jones - Citi

Operator

Good day, everyone. Welcome to Verisign's Third Second Quarter 2019 Earnings Call. Today's conference is being recorded. Unauthorized recording of this call is not permitted.

At this time, I'd like to turn the conference over to Mr. David Atchley, Vice President of Investor Relations and Corporate Treasurer. Please go ahead, sir.

David Atchley

Thank you, operator, and good afternoon, everyone. Welcome to VeriSign's third quarter 2019 earnings call. With me are Jim Bidzos, Executive Chairman, President and CEO; Todd Strubbe, Executive Vice President and COO; and George Kilguss, Executive Vice President and CFO. This call and presentation are being webcast from the Investor Relations website, which is available under About Verisign on verisign.com. There you will also find our third quarter 2019 earnings release.

At the end of this call, the presentation will be available on that site and within a few hours, the replay of the call will be posted. Financial results in our earnings release are unaudited and our remarks include forward-looking statements that are subject to the risks and uncertainties that we discuss in detail on our documents filed with the SEC, specifically the most recent reports on forms 10-K and 10-Q, which identify risk factors that could cause actual results to differ materially from those contained in the forward-looking statements. VeriSign retains its long-standing policy not to comment on financial performance or guidance during the quarter, unless it is done through public disclosure.

The financial results in today's call and the matters we will be discussing today include GAAP and non-GAAP measures used by VeriSign. GAAP to non-GAAP reconciliation information is appended to our earnings release and slide presentation as applicable, each of which can be found on the Investor Relations section of our website. In a moment, Jim and George will provide some prepared remarks and afterward, we will open the call for your questions.

With that, I would like to turn the call over to Jim.

James Bidzos

Thanks, David, and good afternoon, everyone. I am pleased to report another solid quarter for VeriSign. Our results are in line with our objectives of offering security and stability to our customers, while generating profitable growth and providing long-term value to our shareholders.

At the end of September, the domain name base in dot-com and net totaled 157.1 million, consisting of 144 million names for dot-com and 13.4 million names for dot-net with a year-over-year growth rate of 3.8%.

During the third quarter, we processed 9.9 million new registrations, and the domain name base increased by 1.27 million names. Although renewal rates are not fully measurable until 45 days after the end of the quarter, we believe that the renewal rate for the third quarter of 2019 will be approximately 73.6%. This preliminary rate compares to 74.8% achieved in the third quarter of 2018.

For 2019 full year, we now expect the domain name base growth rate to be between 3.2% and 3.7 %. As noted during our recent earnings calls, we are engaged in a process with ICANN to incorporate the terms of Amendment 35 to the Cooperative Agreement, including the pricing terms into our dot-com registry agreement.

For those not familiar with this, let me remind you that under the 2016 amendment to our com registry agreement with ICANN, which extended the term of the agreement, we and ICANN also agree to negotiate in good faith to do two things; first, we agree to reflect changes to the Cooperative Agreement in the com agreement, including pricing terms. Second, we agree to amend the com agreement to include terms to preserve and enhance the security and stability of the com registry or the Internet.

We believe these discussions with ICANN are nearly complete. While it will be inappropriate at this time to provide more details, I can say that we were satisfied with the results so far. As noted, this is an ICANN process and we expect that before long ICANN will be publishing for public comment the documents we have been discussing.

During the third quarter, we continued our share repurchase program by repurchasing 1 million shares of common stock for \$194 million. Our financial position remained strong with \$1.23 billion in cash, cash equivalents and marketable securities at the end of the

quarter. we continually evaluate the overall cash and investing needs of the business and consider the best uses for our cash, including potential share repurchases.

And now I'd like to turn the call over to George.

George Kilguss

Thank you, Jim and good afternoon everyone. Third quarter GAAP results produced revenue of \$308 million up 0.9% year-over-year. Operating expense totaled \$103 million compared to \$105 million last quarter and \$111 million in the third quarter a year ago. The small sequential quarter-over-quarter decrease in operating expenses is primarily a result of the timing of spend related to some sales and marketing programs.

Year-over-year the decrease in operating expenses is primarily due to lower expenses as a result of the sale of our Security Services business, as well as the timing of spend related to periodic and planned changes to and investments in our infrastructure.

Operating income totaled \$206 million compared with \$195 million in the third quarter of 2018. The operating margin in the quarter came to 66.7% compared to 63.8% in the same quarter a year ago.

Net income totaled \$154 million compared to \$138 million a year earlier, which produced diluted earnings per share of \$1.30 in the third quarter this year compared to \$1.13 for the same quarter last year. As of September 30, 2019, the company maintained total assets of \$1.9 billion and total liabilities of \$3.3 billion. Assets included \$1.2 billion of cash, cash equivalents and marketable securities of which \$511 million were held domestically with the remainder held abroad.

I'll now review some additional third quarter financial metrics, which include non-GAAP operating margin, non-GAAP earnings per share, operating cash flow and free cash flow. I will then provide updates to our 2019 full-year guidance.

As it relates to non-GAAP metrics, third quarter non-GAAP operating expense, which excludes \$13 million of stock-based compensation totaled \$90 million compared to \$91 million last quarter and \$96 million in the third quarter a year ago. Non-GAAP operating margin for the third quarter was 70.8% compared to 70.1% last quarter and 68.7% in the

same quarter of 2018. Non-GAAP net income for the third quarter was \$161 million resulting in non-GAAP diluted earnings per share of \$1.36 based on a weighted average diluted share count of \$118.6 million shares. This compares to \$1.33 last quarter and \$1.23 in the third quarter of 2018.

Operating cash flow for the third quarter was \$208 million and free cash flow was \$197 million compared with the \$187 million and \$177 million respectively for the third quarter last year. Beginning with the first quarter 2020 earnings results, we plan to eliminate our discussion and presentation of non-GAAP measures with the exception of free cash flow and adjusted EBITDA on which we will continue to report. As a result, our full-year 2020 guidance, which we will provide on our next call, will only include GAAP metrics. This change is the culmination of the declining trend and influence of our non-GAAP adjustments over the last several years and is consistent with the evolving trends and best practices in financial reporting.

Now I'd like to provide updates to our full year 2019 guidance. Revenue is now expected to be in the range of \$1.228 billion to \$1.233 billion narrowed from the \$1.225 billion to \$1.235 billion range provided on our last call. This revenue range is based on our expectation for continued growth of our domain name base for the full-year 2019 of between 3.2% and 3.7%.

Our non-GAAP operating margin is expected to be between 69.5% and 70% increased and narrowed from the 68% to 69% range provided on our last call. Our interest expense and non-operating income net is now expected to be an expense of between \$44 million to \$49 million narrowed from the \$42 million to \$49 million range provided on our last call.

Capital expenditures in 2019 are now expected to be between \$40 million and \$50 million decreased from the \$45 million to \$55 million range provided on our last call. Cash taxes are now expected to be between \$85 million and \$95 million narrowed from the \$85 million to \$100 million range provided previously.

To recap, Verisign continued to demonstrate sound financial performance during the third quarter of 2019.

Now, I'll turn the call back to Jim for his closing remarks.

James Bidzos

Thanks George. The third quarter was another solid quarter for VeriSign. There was further expansion of the domain name base and year-over-year revenue growth we generated and efficiently returned value to our shareholders. We continued our work to protect, grow and manage the business while continuing our focus on providing long-term value to our shareholders.

And we'll now take your questions. Operator, we are ready for the first question.

Question-and-Answer Session**Operator**

Thank you. [Operator Instructions] And we'll take our first question today from Rob Oliver with Baird.

MattLemenager

Good afternoon. It is Matt Lemenager on for Rob. I appreciate the comments around the ICANN Registry Agreement negotiation. So when -- as we look forward, could you remind us once the public comment period would open up, what does the timeline look like after that? I believe you have to give a six-month notification period before making you can make any formal changes in pricing. So I assume that entire review period with ICANN would be complete by kind of the April 2020 would kind of be the timeframe that it would need to be completed by? But could you just remind us what the timeline looks like after the public comment period opens?

James Bidzos

Sure Matt. Yes, let me explain how what we expect in the public comment period with the caveat that this is an ICANN process, so I can't speak with certainty and I don't speak for ICANN, but I kind of tell you what the expectation is and what they typically do. As I mentioned, we will expect them to shortly publish these documents for comment.

Comment period, ICANN's comment periods are typically about 40 days. There is typically a short period where they review the comments and then after that it's normally expected that some action would be taken on approval on that process. Again, it's ICANN process, I can't tell you with certainty, but that's typically what they do and that's basically an expectation based on what they've done in the past.

In terms of any price increases, we don't guide to pricing. We need to finalize this ICANN process first. So I can't offer you any details on that, but hopefully that answered your question.

Matt Lemenager

Yes, that's helpful. And then another one on kind of the newer initiatives I suppose, is there any update to dot-web and the process there?

James Bidzos

Yes, actually there is some new information since we spoke to you last quarter on dot-web. Just for the benefit, I guess if everybody else on the call for context, there was an auction for dot-web and one of the losing bidders, a company called Afilias, a competitor of ours, filed what is a form of an arbitration proceeding called an IRP in November 2018. That's against ICANN and as a reminder ICANN filed a response to the complaint. We're not a party to that arbitration, but we have filed a request asking to participate in that arbitration as an interested party, which is allowed by ICANN's rules.

So the update is that since last quarter, kind of a significant update I guess is that an arbitration panel has been appointed, convened. It actually held a hearing just very recently, a couple of weeks ago on our request to request to participate, that hearing was held and we expect a ruling on that issue of our participation before the end of the year.

Matt Lemenager

Okay, got it. And then lastly just on the sales and marketing expense, is down 28% every year, I think it is a couple close in a row that has declined. I mean, do you -- is there any expectation, would that go, just trying to take the bottom [ph] of that out into 2020 it seems

like with that level off at some point as we kind of do dot-web and put marketing dollars behind that, or anything, if you could give any color around the sales and marketing expense?

George Kilguss

Yes, sure Matt, this is George. So, as mentioned in my prepared remarks, the big change in expense year-over-year really is a result of sale of our VSS business. As it relates to sales and marketing, there was -- most of that expense came out of sales and marketing year-over-year. So that's primarily the year-over-year decline. As far as where sales and marketing is going in the future, we will provide -- we don't provide guidance on the individual segments, but we will give you an idea of our expectation for next year on our call in February.

Matt Lemenager

Okay, got it, thanks guys.

Operator

Our next question will come from Sterling Auty with JPMorgan.

Sterling Auty

Yes, thanks. Hi guys. Let's start with the renewal rate in the quarter down year-over-year, can you give us some context or color, is there any particular region or factor that led to that decline?

George Kilguss

Sure Sterling. This is George. Regarding renewal rates, our Q3 preliminary renewal rate is expected to be down about 1.2% or 73.6% year-over-year. When you consider the two major components of our renewal rates, our previous renewed rate has held consistent in the mid 80% range, both year-over-year and sequentially. However, we've seen a slight decrease in our first time renewal rate in the quarter.

And while there's a variety of factors that can influence that, it for us has really been a geographic mix in the quarter. As we previously mentioned, China registrars first time renewal rate, as well as what we call the emerging markets had historically lower first time renewal rates. Then let's say more mature markets like the U.S. and Europe and as China has continued to grow for us in 2018 and again in 2019 it is really this change in geographic mix which is causing a little bit of downward pressure on the first time renewal rate.

Sterling Auty

So that makes sense, so maybe a followup is, the 9.9 million new names processed in the quarter, can you give us maybe a little bit more granularity as to what the geographic makeup of that looks like and how that has trended over the last year?

James Bidzos

Well, you point to the 9.9 million gross adds and that's a good stack for us, I mean gross adds were up 3.5% year-over-year in the third quarter which actually was a record gross add third quarter for us, so continued good demand for the product in the third quarter here. As far as the regions of gross adds, they tend to change quarter-to-quarter depending on where registrars are fulfilling demand, but again China has done well for us in the third quarter. Third quarter we saw EMEA do pretty well for us and Asia-Pacific was doing pretty well for us as well in the third quarter.

Sterling Auty

Got it. Moving over to the negotiation with ICANN, I think there is a number of investors that just felt like, whoa why isn't this just a slam-dunk quick put in item 35 and you're done? You know, I think from some of the comments that you've made in the earnings calls, it does seem to be more of a negotiation and negotiation usually means both sides want something. There has been some question that I get from investors as to whether the ICANN fee would go up or what other elements we might actually see? Is there any just high-level color that you can give even prior to seeing the public comment documents?

James Bidzos

So your question is specifically about when in terms of the publication for public comment? I'm not sure, you kind of lost me right at the end there.

Sterling Auty

Nope, so the...

James Bidzos

I guess that's exactly what the question is.

Sterling Auty

Yep, to be very specific, the question is, plans of negotiation should we expect that not only would we see changes to pricing coming into the Registry Agreement from the item 35 will there be other changes to the Registry Agreement since it is a negotiation?

James Bidzos

Well there is -- so I think, no I said that we can't provide any details, but I can reiterate and tell you that is an obligation to move the changes from the Cooperative Agreement which is the pricing, and we are satisfied with that process, and that is the amendment 35 pricing. There is also an obligation resulting from the 2016 extension to provide the security and stability. So I can tell you that in that process we're satisfied as well with that process, with the discussions that we have had, including security and stability. And in that process any obligations or expenses that arise from it, that's also an area where we're satisfied with the progress and also the amendment 35 pricing obviously. So hopefully that answers your question.

Sterling Auty

Yes, that makes sense. Thank you, Jim. And then last question, George just back you know as we think about the new guidance for the 3.2% to 3.7% growth in the domain overall, should we think that this would be a continuation of the trend in the renewal rate

that gets us to that level for the full-year or is there any other factors that kind of weigh on it?

George Kilguss

Oh I mean, Sterling as normal there is seasonality we have in the fourth quarter i.e. there are quite a few holidays in the fourth quarter in the U.S. and abroad, and so it's obviously a combination of adds and renewal rates, but our guidance fully reflects our expectations for the full-year performance.

Sterling Auty

Thank you, guys.

Operator

We will take our last question from Nick Jones with Citi.

Nicolas Jones

Hi, thank you for taking my question. I guess thinking a little bit longer term, is there any discernible differences in kind of the number of people who are parking domains today than maybe were during the last recession and is there kind of any difference in the business today or are the profiles registrant set that you could add some color around that are different today?

James Bidzos

I think that's a very tough question to get into any specifics on, but generally I can tell you that this business has shifted steadily over the years. I mean you probably remember a few years ago when Google was making changes to its search algorithm that affected the way that people monetized domains, that affected registrar buying habits. Geography can play a role as well.

People buy domains for different purposes and different geographies. So it's -- there are many purposes obviously from branding yourself and building businesses. People buy domains for defensive registration purposes. There are lots of different reasons they buy

them, they vary over time, other external factors that influence them, geographies, so it's kind of hard to generalize.

I can't think of any standout change or shift that I can point to that indicates any specific change or aspect of our business. As George said, this was a record Q3 with 9.9 million gross adds and so demand is good for the product, whatever the mix maybe, that's a subject for publication of some date in the future we might look at that. That's a good question, but it's really hard to sort of give you a detailed sort of granular answer to that. There is just so much activity and so many different reasons that people buy domains, and so many different types of monetization as well.

George Kilguss

Yes, and as a reminder Nick, we are thick registry, so we really, excuse me, a thin registry, so we don't see the registrars that provide that.

James Bidzos

We don't see the registrars that provide that, so we don't have quite as much information, but we certainly study these trends. And as I said there are diverse set of reasons that people buy domains.

Nicolas Jones

I got to appreciate it. One more, but it's kind of been the upcoming political cycle and the growing scrutiny on kind of big tack, is there any kind of increased regulatory risk that VeriSign you guys trying to implement amendment 35 as we get into 2020 or how should we think about that?

James Bidzos

We've read what you read about that, that's all we know. I haven't read anything lately. We've read what you've read.

Nicolas Jones

Okay, well I appreciate taking my questions.

James Bidzos

Sure.

Operator

That will conclude today's question-and-answer session. At this time, I will turn the conference over to Mr. David Atchley for final comments.

David Atchley

Thank you, operator. Please go to the investor relations department with any followup questions from this call. Thank you for your participation. This concludes our call. Have a good evening.

Operator

That does conclude today's conference call. Thank you for your participation. You may now disconnect.