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FORR.OQ - Q2 2022 Forrester Research Inc Earnings Call

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Trevor Romeo *William Blair & Company L.L.C., Research Division - Associate*

Vincent Alexander Colicchio *Barrington Research Associates, Inc., Research Division - MD*

PRESENTATION

Tyson Seely

Thank you, and hello, everyone. Thanks for joining today's call. Earlier this afternoon, we issued our press release for the second quarter of 2022. If you need a copy, you can find one on our website in the Investors section.

I'm joined this afternoon by our Chairman of the Board and CEO, George Colony; and Forrester's Chief Financial Officer, Chris Finn. George will open the call this afternoon, and Chris will follow with a financial update. We'll then go into Q&A. Kelley Hippler, Chief Sales Officer; and Carrie Johnson, Chief Product Officer, will also join us for the Q&A portion of the call. .

Before we begin, I'd like to remind you that this call will contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Words such as expects, believes, anticipates, intends, plans, estimates or similar expressions are intended to identify these forward-looking statements. These statements are based on the company's current plans and expectations and involve risks and uncertainties that could cause future activities and results of operations to be materially different from those set forth in the forward-looking statements. Factors that could cause actual results to differ are discussed in our reports and filings with the Securities and Exchange Commission, and the company undertakes no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

Lastly, consistent with our previous calls, today we will be discussing our performance on an adjusted basis, which excludes items affecting comparability. While reporting on an adjusted basis is not in accordance with GAAP, we believe that reporting numbers on this adjusted basis provides a meaningful comparison and an appropriate basis for our discussion. You can find a detailed list of items excluded from these adjusted numbers in our press release.

And with that, I'll hand it over to George.

George F. Colony - *Forrester Research, Inc. - Founder, Chairman, CEO & President*

Thank you for joining Forrester's Q2 investor call. We've seen strong results across the business, and while we remain confident we can deliver on our bottom line results, the dynamic and changeable environment will impact our top line. At midyear, I would like to highlight 3 key themes in our business. Number one, Forrester Decisions continues to stay on its fast growth track; two, we are managing economic and product transition headwinds; and three, we continue to grow contract value at double-digit rates. I expect these dynamics to persist through 2022 and into 2023.

In the second quarter, we achieved revenue growth of 15%, exceeding the high end of our guidance. This was led by double-digit growth in our research business and a nearly 200% increase in events revenue. The company reached a 19% operating margin, exceeding guidance. Earnings per share surpassed the high end of guidance by $0.24.

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We continue to generate strong cash flow, part of which we used to pay down debt and to buy back company stock. We delivered our fourth consecutive quarter of double-digit contract value growth. Now that said, our CV growth dropped to 10% in Q2, down from 15% in the previous quarter. CV bookings growth slowed for 3 reasons: one, higher-than-expected sales attrition and a slowness in hiring new sales reps; two, lower conversion rates driven by geopolitical and economic conditions; and three, higher-than-normal seat holder turnover in our client accounts. Despite these factors, we expect to ramp our quota-carrying head count in the second half and remain optimistic that we will meet our full year guidance for CV growth, EPS and profit margin.

Forrester Decisions, our new flagship research product, continues on its growth path as we approach the 1-year anniversary of its launch. We are seeing good enrichment deals. In the quarter, a large U.S. telecom company upgraded into Forrester Decisions, a CV increase of 55%. We also gained a large contract with the Department of the Canadian government for Forrester Decisions, and this was our first win since Forrester was added to the NMSO standing offer preferred vendor agreement.

We are continuously improving the Forrester Decisions platform. In August, we plan to expand Forrester Decisions from 15 services to 16 services, adding the digital business strategy persona to the portfolio. We designed the service for digital leaders, primarily B2C companies who are responsible for building exceptional digital experiences and increasing loyalty.

In Q2, we added benchmarking to the platform. Our clients expect to use benchmarks to pinpoint where they are lagging competitors, where they should target their future spending and where they should be trimming expense. Our benchmarks include global averages as well as metrics for specific vertical markets.

The Forrester Decisions platform offers a rich and diverse portfolio of research, and here are a few examples that stood out in the quarter. Our U.S. tech labor market forecast revealed that there has been a substantial migration of talent out of Silicon Valley in Northeastern metro centers to Southern states. We released the 2022 North America Customer Experience Index of 300 brands, revealing the largest drop in customer experience quality in the history of the benchmark.

The pandemic induced innovation and CX improvements decelerated, and companies failed to keep pace with the heightened expectations of consumers. And this is important because small changes in CX index scoring are an early indicator of revenue change for companies. As an example, a 1 point drop in the CX Index score for a mass market auto manufacturer [pre stages] in $1.2 billion loss in revenue.

We are diligently working to ensure that our research is relevant to our clients as they manage supply chain imbalances, inflationary pressures and threats of recession. Disruption and digital challenges continue to make this the golden age of research.

Now as I mentioned earlier, our events business is recovering from the pandemic. We returned to a hybrid format in Q2 with our 2 biggest events of the year, the B2B North America Summit and Customer Experience North America; and 2 global events, CX EMEA and CX Asia Pacific. C-level attendance grew 20% for the B2B Summit and 30% for CX North America. Attending ticket selling prices grew 25% from 2021 to 2022, and we recorded high attendee satisfaction scores in all regions and in all events in the second quarter.

Average sponsor renewals for next year's events grew 35%, and global sponsor deals are up 100% for next year. And my personal favorite part of our Q2 events was the sixth time Grammy nominee Black Pumas concert in Austin. It was wonderful to see our clients celebrate being together and celebrating a return to normalcy.

Now before I conclude, I would like to take a moment to provide a quick update on Forrester's ESG initiatives. As noted on our previous call, Forrester aims to cut carbon emissions 50% by 2025. Our anywhere work strategy will help us achieve this goal, and we are also assessing our travel policies and are migrating more of our tech platforms and services to the cloud to further reduce emissions.

I will now turn the call over to Chris Finn, Forrester's CFO, who will give you a financial update. Chris?

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L. Christian Finn - *Forrester Research, Inc. - CFO*

Thanks, George, and thanks again to everyone for joining us. As George mentioned, our second quarter results were strong with revenue, margins and EPS coming in ahead of the high end of our guidance. We continue to operate in a volatile environment with macroeconomic uncertainty and FX headwinds that we expect to continue as the year unfolds. This has led us to bring down our top line guidance but keep our margin and EPS outlook constant given the confidence in our ability to control the P&L while creating a solid foundation from which we can grow in 2023 and beyond.

Following up on George's remarks, there are many bright spots that have led to our year-to-date results that we've reported thus far. We continue to be pleased with the market reception and pricing that we are achieving with the new Forrester Decisions platform, and we are excited to see people at our in-person events.

Let me start by focusing on the highlights on the second quarter. As George mentioned, we delivered CV growth of 10% in the quarter and overall revenue growth of 15% driven by research and events businesses. Specifically, for the total company, we generated $148.2 million in revenue compared to $128.7 million in the prior year period, a 15% year-over-year increase as I just mentioned. This includes an approximate 1 percentage point headwind from FX.

In terms of segment results for the quarter, research revenues increased 10% compared to the second quarter of 2021 as a result of the double-digit growth in CV. Client retention, client count and wallet retention were down from prior quarter, driven by a combination of an elongated sales cycle, lower conversion rates and sales capacity constraints, which were largely driven by lower ramp sales head count based on higher attrition and an ongoing challenging hiring environment. This resulted in a slow start to our bookings performance in the quarter, although we realized improved momentum coming out of Q2 with a stronger June performance.

We have also seen that our clients are continuing to experience delays in making buying decisions given the macroeconomic headwinds they are facing. As we noted last period, we expect continued noise around our client count and retention rates as we migrate our legacy base to the Forrester Decisions platform. With all that said, we remain on track for our Forrester Decisions bookings plan, and we're confident in hitting our CV plan for the year.

Our consulting business posted revenues of $39.3 million, which were down 4% compared to the prior year due to a combination of our analysts continuing to shift a portion of their focus to delivering on our CV business, along with some of our clients delaying scheduled projects. And finally, our events business posted revenues of $19.5 million, representing an increase of 191% compared to the second quarter of 2021. This growth was driven by the return to in-person events this year, and we were very happy to see people back in person.

Continuing down our P&L on an adjusted basis. Operating expenses for the second quarter increased by 10% driven by increased expenses related to the move to in-person events as well as higher head count and increased compensation costs. Specifically on head count, for the second quarter, we were up 13% compared to the same period in 2021. This was below our hiring expectations, leading to additional savings in the period.

Operating income increased by 42% to $27.9 million or 18.8% of revenue in the current quarter compared to $19.7 million or 15.3% of revenue in the second quarter of 2021. Interest expense for the quarter was $0.5 million as compared to $1.1 million in the second quarter of 2021. This reduction was driven by lower outstanding debt.

Finally, net income increased 51% and earnings per share increased 52% compared to Q2 of last year, with net income at $19.2 million and EPS at $1 for the current quarter, compared with net income of $12.7 million and earnings per share of $0.66 in the second quarter of 2021.

Looking at our capital structure. During the first half of 2022, cash flow from operating activities was $34.8 million and capital expenditures were $2.7 million, resulting in $122.6 million of cash and investments as we exited the quarter. We also paid down $10 million of our revolver during the second quarter, leaving us with $50 million of outstanding debt, and we repurchased $5.7 million of our common stock, leaving us with approximately $75 million of our stock repurchase authorization as of June 30.

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I'll now walk you through what we are expecting over the remainder of the year and provide additional commentary. As I stated upfront, the macroeconomic headwinds remain, many of which, such as the new COVID variant, the ongoing war in Europe and the potential for a recession, along with currency headwinds, are out of our control. Specifically, we see the drivers of top line results going forward as follows: one, the strengthening dollar will continue to put pressure on our top line; two, as mentioned, we do have head count challenges that are affecting our top line results as well. We have a strong pipeline of talent but are finding our lead time to hire new employees longer than expected, largely driven by what continues to be a tight labor market. Further, while attrition has improved from the highs of last year, it remains elevated. Three, our sales cycle, given the environment our clients find themselves in, specifically our European clients, we are seeing longer sales cycles and lower conversion, which is also adding pressure to our top line.

With that said, we've made progress on our sales resource hiring and currently have a record number of ramping sales heads this period. As we increased our ramp sales head count in the second half, we fully believe we can execute and deliver on double-digit CV growth this year as planned. However, given the slow start in our Q2 bookings and the pacing of bookings in the second half as head count ramps, we expect revenue recognition to be delayed commensurately with bookings.

In addition, as I already mentioned, FX and the macroeconomic landscape are also likely to pressure our top line results in the second half. But despite our guide down on the top line, we remain confident in our ability to manage the P&L and deliver on our margin and EPS guidance that we issued at the beginning of the year.

Let me provide some additional color for the third quarter and balance of the year starting with the top line. For the full year, we continue to expect that FX will be approximately a 1% to 2% headwind to the business with an insignificant effect on operating margin. In our research business, for the third quarter, we expect mid- to high single-digit revenue growth. And for the full year, we expect high single to low double-digit growth based on our projected CV bookings for 2022. For our consulting business, we expect revenue to be low to mid-single-digit growth for the third quarter and low single digits for the full year.

Finally, for our events business, our revenue guidance continues to include the assumptions that we will be able to hold hybrid events during the year, which is highly dependent on local conditions in each of the cities where we hold events across the globe. We are carefully monitoring the new COVID variant and will adjust as necessary. But the events we have held thus far this year have been very successful. Given all of this, we expect third quarter revenues to increase by 190% to 200% compared to prior year, and we expect event revenues for the full year to approximately double our results from 2021.

Putting all those factors together for the full business, we would now expect total revenue of approximately $125 million to $129 million in the third quarter. And for the full year, we expect total revenue to be $535 million to $545 million.

In terms of other guidance, in the third quarter of 2022, we expect our operating margin to be 8% to 10%. We continue to expect our full year operating margin to be 11.5% to 12.5% given additional cost controls and focused investment initiatives. We also continue to expect interest expense at $2.5 million for the year as our lower debt balance should offset expected increases in rates.

In the third quarter and for the full year of 2022, we continue to expect an effective tax rate of 30%. Finally, for the third quarter, we expect our EPS to be in a range of $0.35 to $0.41, and we continue to hold our guidance for the full year in the range of $2.25 to $2.35.

We remain cautiously optimistic about the months ahead. While there are still many macro headwinds, both geopolitical and economic, we are confident in what we have laid out today and the shareholder value we look to create going forward.

With that, let me hand it back to George for some concluding remarks before Q&A.

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George F. Colony - *Forrester Research, Inc. - Founder, Chairman, CEO & President*

Thanks, Chris. Let me provide a quick summary before we go to Q&A. To sum up our year-to-date results and outlook, there are 3 key points: one, Forrester will continue to grow and improve Forrester decisions; two, we will navigate our economic and transition headwinds; and three, we expect to continue to grow CV at double-digit rates. .

Forrester has encountered a number of recessions and economic disruptions over decades of operation, and I'm confident that the company will manage whatever conditions that develop over the coming months. At our company meeting last week, we talked about doubling down on our client focus. Thank you to our Forrester teams for being on the side and by the side of our clients. This is even more critical in challenging times.

Thank you for listening to the call, and I will now turn the call over to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Andrew Nicholas with William Blair.

Trevor Romeo - *William Blair & Company L.L.C., Research Division - Associate*

This is actually Trevor on for Andrew. Just wanted to see if you could kind of elaborate a bit more on the macro uncertainty piece. I know you mentioned kind of lower conversion rates and some sales cycles extending. Are you seeing any signs of clients actually starting to kind of actively pull back or cancel subscriptions at this point? Or is it kind of just those factors? And are any of those dynamics kind of concentrated in a particular customer segment? Or is it kind of fairly broad-based across the customer base?

Kelley Hippler - *Forrester Research, Inc. - Chief Sales Officer*

Trevor, it's Kelley Hippler here. Thank you for the question. So in terms of the softness that we're seeing, a lot of it has been centralized a little bit more so in Europe than in other places, so -- which is not unusual given the war that is going on over there. And then the drop in conversion rate, as Chris alluded to, we are seeing some longer sales cycles but are confident that a lot of that business, we will still win during the course of the year.

Trevor Romeo - *William Blair & Company L.L.C., Research Division - Associate*

Okay. Great. And then I know you mentioned you still expect to hit the CV growth target for the year. Just wondering if you could go a bit deeper there since there was a bit of deceleration relative to the past few quarters. Just wondering if you could kind of talk about some of the factors like new logos, new seats per client and pricing or anything else. Which of those kind of decelerated a bit this quarter? And how would you expect that to play out the rest of the year and would expect to hit the double-digit growth even if the macro does get worse from here?

Kelley Hippler - *Forrester Research, Inc. - Chief Sales Officer*

Sure, Trevor. Kelley again here. And what I would say is I think our biggest challenge from a performance perspective was just the number of ramp reps that we had out in the field. So we have a record number of sales reps that are going to be coming off of ramp in this quarter. And so a lot of what we saw from a metrics perspective was just driven by not having as many folks out in the field as we were anticipating. We continue to see good wallet retention on the Forrester Decisions portfolio and still continue to see a little bit of noise with some of our legacy products.

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George F. Colony - *Forrester Research, Inc. - Founder, Chairman, CEO & President*

And Trevor, George here. I'd say much more confidence comes from the velocity we're seeing in Forrester Decisions. It is on track, on plan, and this product is performing well.

Trevor Romeo - *William Blair & Company L.L.C., Research Division - Associate*

Got it. That is good to hear.

Operator

Our next question comes from the line of Vincent Colicchio with Bernstein (sic) [Barrington].

Vincent Alexander Colicchio - *Barrington Research Associates, Inc., Research Division - MD*

Yes. I'm curious with your CV pipeline. You had mentioned that the bookings for CV improved in June. Curious what your pipeline looks like right now versus this period last quarter?

Kelley Hippler - *Forrester Research, Inc. - Chief Sales Officer*

Vince, sure. It's Kelley here. I will take that one. So in terms of pipeline for Q3, we are starting Q3 from a better position than we started Q2, and part of that as well has been our strategy with Forrester Decisions to sign multiyear deals. So as you might recall, we launched that product last August. And from there forward, about 70% of the Forrester Decisions deals that we sold were multiyear deals. So the good news is we walk into Q3 and Q4 with more of our business already booked than we have previously.

And then in addition to that, we've got ramping reps. So our pipeline is in better shape going into Q3 than it was going into Q2.

Vincent Alexander Colicchio - *Barrington Research Associates, Inc., Research Division - MD*

And did I hear that you're on track for your previously committed sales growth goal? And if so, are you assuming attrition levels decline from where they are currently in the next 2 quarters?

Kelley Hippler - *Forrester Research, Inc. - Chief Sales Officer*

Yes, so we are on pace to not only get to our original targets for 2022, but we've actually started to proactively hire for 2023 to help make up some of the ground from the attrition that we saw in Q2. So we expect to add double-digit head count throughout the course of the year to not only help us get to our goals for 2022 but to keep us at double-digit CV growth as we head into 2023.

Vincent Alexander Colicchio - *Barrington Research Associates, Inc., Research Division - MD*

And the attrition, was it highly concentrated with more senior people? What does the distribution look like?

Kelley Hippler - *Forrester Research, Inc. - Chief Sales Officer*

Sure, Vince. So in terms of the distribution, I would say it was some of our more senior reps who decided to opt out of Forrester with some of the change in strategy, coupled with a very hot job market that made it lucrative for them to do so. But the good news is for those folks who are joining

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Forrester, they are coming into Forrester understanding and knowing about our change in strategy to focus on CV, how we want to be working with our clients on their side and by their side. So the new hires are fully bought into the model and where we're going and how that's going to help add more value for our clients moving forward.

Vincent Alexander Colicchio - *Barrington Research Associates, Inc., Research Division - MD*

And I think last quarter, you had talked about improving the ramp time for new reps. You indicated you could reduce it from 1 year to 9 months. Are you at that -- are you seeing that?

Kelley Hippler - *Forrester Research, Inc. - Chief Sales Officer*

We are on pace for that, which, again, given some of the delays that we saw in hiring, we'll put some of this production capacity at the back end of Q3 into Q4, but we are definitely seeing that the Forrester Decisions portfolio makes it much easier to either qualify or disqualify potential opportunities for the sales force. So it's -- we do expect to see ramp time continue to come down.

Operator

That concludes today's question-and-answer session. I'd like to turn the call back to management for closing remarks.

Tyson Seely

Thank you, everyone, for joining us today. This is Tyson. I will be around in the coming weeks if there are any follow-up questions. I hope everyone has a great rest of their summer. Thank you.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.

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