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Q3 2023 Thryv Holdings Inc Earnings Call

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PRESENTATION

Operator

Thank you for holding, and welcome everyone, to the Thryv Third Quarter 2023 Earnings Call. (Operator Instructions)

I will now turn the call over to Cameron Lessard, Head of Investor Relations. Mr. Lessard, please go ahead.

Cameron Lessard ***Thryv Holdings, Inc. - Assistant VP of IR & Treasury***

Thank you, operator. Hello, and good day to everyone. Welcome to Thryv's third quarter 2023 earnings conference call. On the call today are Joe Walsh, Chairman and Chief Executive Officer; and Paul Rouse, Chief Financial Officer. A copy of our earnings press release and investor presentation can be found on our website at thryv.com or in the Investors section at investor.thryv.com.

Please acknowledge, comments made on today's call and responses to your questions may contain forward-looking statements about the operations and future results of the company. These statements are subject to the risks and uncertainties described in the company's earnings release and other filings with the SEC. Thryv has no obligation to update the information presented on this conference call.

Finally, our speakers will reference certain non-GAAP financial measures, which we believe will provide useful information for investors. Reconciliation of those measures to GAAP will be posted on our website.

With that introduction, I would like to turn the call over to Chairman and CEO, Joe Walsh.

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Good morning, Cameron, and thank you all for joining us on the call today to discuss our third quarter results. I'd like to dive in here with 2 big ideas. The first is our SaaS revenue beat guidance on both the revenue and the EBITDA line, all while carrying additional overhead that was allocated because we had lesser revenue in Marketing Services. So this is really a standout quarter and it shows the strength that's developing in our SaaS business.

Secondly, we finally got behind us, this looming third quarter we've been talking about for well over a year, where revenue recognition was going to be light for the quarter and would optically make it look like we had weak revenue. So we generated roughly $7 million in adjusted EBITDA, but $37 million in cash flow. And so it sort of underscores the strength of this overall business and the management team is very much in control of the cost and able to look, in this case, more than a year ahead and tell you how this is going to turn out. So we're using that cash to strengthen our balance sheet to pay down debt that shows kind of the strength of the Marketing Services business, even though it's declining, still very, very resilient and very forecastable.

I'd like to take you through our SaaS quarterly highlights. SaaS revenue grew 19% year-over-year and sequentially, it grew 8%. SaaS adjusted EBITDA was much better than guidance despite the impact of Marketing Services operating expenses. SaaS adjusted gross profit improved 25% year-over-year, delivering an adjusted gross margin of approximately 67%. Client growth was up 29% year-over-year, and engagement, our North Star driving engagement was a 22% growth. We're really pleased so far with Command Center. It's just been in beta this last period, but our team has been working closely with early adopters and making weekly updates and

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we'll wrap up this beta period very soon.

With little to no promotion, we've received over 15,000 sign-ups. We've connected thousands of channels, streamlined over 3 million messages and we've seen positive signs from nearly 10,000 phone calls in hours of video meetings. So during the beta period, we found a few bugs you would, wouldn't you? We've really solidified and strengthened the product and we're ready a little later this month to go out with our full general release.

We're achieving sign-ups to Command Center in 2 ways. First, we're offering unassisted online sign-ups, which take less than 60 seconds, really easy to sign up. And we've seen these users, in many cases, self-grade and actually purchase where they're buying more channels or more seats are somehow expanding. Those that haven't expanded will monitor their usage and their engagement and those with the highest usage will actually turn over to our sales force to contact them, work with them and discuss future expansion opportunities. These are what, I guess, you would call really hand-raisers.

Second, we're leveraging our global sales force. With Command Center and their toolkit, business advisers are well positioned to provide value as trusted partners. This will help them drive more demos and sales to our other centers in the future.

With that, I'd like to turn it over to Paul Rouse, and let him take us through our third quarter financial results. Paul?

Paul D. Rouse ***Thryv Holdings, Inc. - CFO, Executive VP & Treasurer***

Thanks, Joe. As a reminder to listeners, we are going to focus on our 2 segments, SaaS and Marketing Services, which includes results from domestic and international operations. We feel this is more beneficial in modeling and understanding the business. Additional detail between domestic and international, where each segment can be found in the appendix section of the investor presentation.

Okay, let's jump into the results, beginning with our SaaS segment. Third quarter revenue was $67.4 million, an increase of 19% year-over-year and 8% sequentially and above our guidance range. Third quarter SaaS adjusted gross margin expanded to 66.6% versus 63.5% in the prior year, representing a 310 basis point increase year-over-year and a 150 basis point increase sequentially. SaaS adjusted gross margins will see continued expansion with the promotion of centers and we believe they will continue to expand with the upsell motion from the new Command Center product, which is now widely available to all of our customers. SaaS adjusted EBITDA was negative $504,000 and significantly exceeded our guidance range of negative $3.5 million to $4 million.

Let me provide a bit more color on our SaaS adjusted EBITDA margin. As previously communicated, we allocated operating expenses as a percentage of revenue between our 2 segments, SaaS and Marketing Services. Due to materially lower print revenue in Marketing Services, SaaS carried significantly more operating expense during the quarter, which negatively impacted our adjusted EBITDA and resulted in a slight reported loss in the third quarter compared to continued and sustained margin improvements over the past several quarters.

However, I am pleased to report that we were able to substantially narrow this EBITDA loss more than $3 million by effectively managing our go-to-market channels and customer acquisition initiatives. This is a testament to the strength of our team and our ability to execute on our strategic plan. As Joe said in his opening remarks, we are now past the print directory revenue recognition dynamic. We remain confident in our long-term growth prospects and are focused on accelerating profitable growth in our SaaS business. And we will continue to invest in our key growth priorities, while managing our operating expenses carefully.

SaaS subscribers grew to approximately 66,000 at the end of the third quarter, an increase of 29% year-over-year. SaaS ARPU decreased to $365 in the third quarter and represents a 3% decrease year-over-year. With our new product-led growth strategy, we anticipate continued subscriber growth, but monthly ARPU may face some headwinds due to pricing mix. While our SaaS subscribers are ramping, they are signing up for lower introductory packages than our current average ARPU. For example, our popular Marketing Center offering is currently priced at $1.99 and $3.49 per month in the U.S. As we move forward, this will allow us to upsell and cross-sell additional products, which will benefit net dollar retention in the future.

Third quarter seasoned net dollar retention was 92%, an increase of 300 basis points sequentially. As discussed previously, with the

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introduction and expansion of our new centers like Marketing Center, paid Command Center and other products such as ThryvPay, Signatures, website builder and other marketplace apps and integrations will make it easier to upgrade customers while providing excellent customer service and support, enhancing our opportunity to expand our NDR.

Moving over to Marketing Services. Third quarter revenue was $116.5 million, within the midpoint of our guidance. Third quarter Marketing Services adjusted EBITDA was $7.8 million, resulting in an adjusted EBITDA margin of 7%. This was expected due to the timing around revenue recognition of our print directories, lengthening from 15 months to 18 months.

Third quarter Marketing Services billings was $159.5 million, representing a decline of 19% year-over-year. Third quarter consolidated adjusted gross margin was 60%. Third quarter consolidated adjusted EBITDA was $7.3 million, representing an adjusted EBITDA margin of 4%. The Finally, our net debt position was $377 million at the end of the third quarter. Our leverage ratio was 1.8x net debt to EBITDA, which was well below our covenant of 3x. The company generated an additional $37 million in free cash flow in the third quarter and used $42.5 million to pay down our term loan, including the additional $10 million of payments made in October, we have made $105 million in year-to-date term loan debt repayments in 2023.

Lastly, in regard to warrant expirations on August 15, approximately 8.3 million warrants expired, unexercised and the company no longer has any warrants outstanding. Warrant holders exercised approximately 1.2 million warrants, resulting in the issuance of 646,000 shares of common stock, resulting in minimal dilution and generating $15.8 million of cash proceeds for the company for debt paydown.

Now let's turn to guidance. We are raising our full-year SaaS revenue guidance to the range of $260 million to $261 million. We are also raising our full-year SaaS EBITDA guidance to the range of $9 million to $9.5 million. For the full year 2023, we are lowering our outlook for Marketing Services revenue in the range of $650 million to $655 million and adjusted EBITDA in the range of $177 million to $179 million. The reasons for the revision is that we are facing some FX pressure and have proactively made the decision to retain more of our Marketing Services sales force and enter into a new commission structure in an effort to drive higher productivity and growth in our SaaS business. We ultimately view this as an investment that will benefit our SaaS business in future periods.

I'll now turn the call back over to Joe.

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Thank you, Paul. Our international business is continuing to develop nicely. We now have all centers available in all markets. That's really just as recently as just the last couple of months. And that's part of our optimism as we look ahead to next year, we believe with more centers to sell our international business will continue to develop at a nice pace.

I wanted to comment on Marketing Center. Marketing Center is a platform that's a lot closer to the old advertising and marketing services that our Marketing Services business sells. And therefore, we're finding more application, more traction, if you will, with those Marketing Services customers. So I think you will see us do a really good job of more deeply penetrating the zoo if you will. Now that marketing -- excuse me, Marketing Center is really kicking along and we've got a bunch of happy customers and the referral network is spreading and the word-of-mouth is spreading, confidence is there in the sales force and things are beginning to build. So I think you'll see more penetration there.

In Paul's remarks, he raised guidance for our SaaS business and we're delighted that the SaaS business is continuing to really develop. The metrics are improving. We're driving to a Rule of 40. You're seeing net dollar retention expand, gross margins expand, you're seeing an overall acceleration. As we look ahead to next year, we expect revenue growth will accelerate and we expect margins will expand in the SaaS business. And we're continuing to push toward being a best-of-breed Rule of 40 business. And we won't be 40 next year, but that's the direction that we're driving toward. And growth in both the revenue growth and margin expansion will help us to get there. So that's our thinking on the quarter.

Operator, why don't we open it up for questions?

QUESTIONS AND ANSWERS

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Operator

(Operator Instructions) Our first question comes from the line of Arjun Bhatia with William Blair.

Arjun Rohit Bhatia ***William Blair & Company L.L.C., Research Division - Co-Group Head of the Technology, Media, and Communications Sector & Analyst***

Joe, one of the things that jumps out this quarter, I mean, I think it sticks out in a good way is the net new customer additions on the SaaS business. I think you added 10,000 customers quarter-over-quarter. What -- it seems like I'm sure Command Center has something to do with that. But can you just unpack that a little bit? And then talk about how you capitalize on these new customer adds and drive expansion down the line because it seems like a huge opportunity for you?

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Yes. Command Center doesn't have a whole lot to do with it because the Command Center, which is still in beta, we're going to remove the beta later this month, most of those sign-ups are just free -- freemium and they don't go in the customer account. There are a number of those that after they signed up, matriculated through and self-upgraded and are now paying -- those are paying customers. But we've had no sales effort against it -- no -- sales force hasn't been involved in selling anything. So what you're seeing mostly is uptake of Marketing Center.

And so as I mentioned in the prepared remarks, the Marketing Center is much, much closer to the purpose for which people were buying our Marketing Services. And so our -- we're hunting in the zoo with more effect and we're getting more traction. And that's working out really well. And in terms of your -- the second part of your question, a lot of them came in at the lower level or the entry-level price and there were even some distinct groups that we did some promotional stuff to move them over to allow us to decommission some older systems. And so that's why you see a little bit of a tug down on ARPU. It's not a permanent problem. There's actually quite a bit of scope to increase them over the next period of time. So it's sort of coiling the spring, if you will, for net dollar retention in the future.

Arjun Rohit Bhatia ***William Blair & Company L.L.C., Research Division - Co-Group Head of the Technology, Media, and Communications Sector & Analyst***

Yes, that's great to hear on Marketing Center. And Paul, you mentioned lowering the Marketing Services guidance. Part of that was driven by FX. Can you maybe just expand a little bit on that? What was the -- is this mostly the acquired businesses that are having an impact with Sensis and others? And maybe if you can just touch on some of the sales restructuring that's going on there and how we can expect that to play out over the next year or so?

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Sure. The FX pressure we were experiencing in our plan was related to Australia and New Zealand. On the sales restructuring, we look forward all the time. So we kind of think what's best for 2024. So we thought, given we now have a Marketing Center and with success we were having during the third quarter, we should really maintain the sales force we have right now and put the right commission structure in place to drive revenue now and come out into 2024, very strong. So we made an investment in ourselves there and we think that's the best long-term move for the company and that's the thinking behind that.

Operator

Our next question comes from the line of Scott Berg with Needham and Company.

Scott Randolph Berg ***Needham & Company, LLC, Research Division - Senior Analyst***

Hi, everyone. Congrats on the nice quarter. I guess, I got a couple -- Joe, I want to start with or maybe it was Paul's statement, but the statement on expecting SaaS revenue growth to accelerate in '24, I guess what gives you the confidence in that statement customer additions on the SaaS side were obviously strong, but the macro is still kind of weighing out there. Just help us maybe understand the puts and takes of where that confidence comes into play?

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Yes. I mean, it really comes back to -- if you look at where we've been coming from, we've been coming from selling really 1 center in 1 stroke kind of 2 countries. And as we look forward to '24, we are all singing, all dancing selling the full platform now with 3 centers, a

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forthcoming next year and doing it in all markets. And so that's kind of where the confidence comes from. We're getting a lot of traction now with Marketing Center. It's really moving. We talked earlier last year about how we kind of kept it slow in the beginning to make sure we got it figured out, and it's moving quite briskly now.

So you're right, the macro is not all better. It's not wonderful. So I'm not saying that we'll have massive acceleration, but we do believe there will be acceleration next year just based on selling the full platform in all markets.

Scott Randolph Berg ***Needham & Company, LLC, Research Division - Senior Analyst***

And then from a follow-up question perspective, I know the question was just asked about customer additions. But what was different with SaaS customer additions this quarter versus last quarter? If I go back to my notes in the second quarter, Joe, you kind of pulled back from top of the funnel marketing to some of those customers because they weren't converting as strong as what you've seen historically. But why kind of the influx maybe in this quarter?

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

We basically went hard into the zoo. We really went after a lot of the standing Marketing Services customers with Marketing Center. And we've talked about this a little bit in the past, Scott, that if you think about what the business center does, our original biggest center does, it's a CRM, and it requires some amount of business process change to adopt it and incorporate it into your company. Marketing Center is a lot closer to the Marketing Services products they've been buying in the past. It's more kind of apples-to-apples, maybe red apples go into green as opposed to the business center, which is like an orange. It's a very different thing.

And so we're finding a pretty easy conversation there. And so it's increasing our optimism about how we'll do, let's say, in '24, driving deeper into the zoo for penetration. And as you've already -- you've already known, and we've already discussed, that's our best customer acquisition channel is when we're able to call them standing accounts. We already know them. They already know us. They're paying us where their credit is good, like it's nice as opposed to going out into the outside world trying to meet new people.

So what you're seeing is an acceleration of our drive into the base. And if I may, there's a little bit of cannibalization there, too, where we're not only just adding a center, but in some cases, moving some of those customers over into Marketing Center. We do have a melting iceberg in our Marketing Services business. We aren't doing anything to really grow that business. We're not working hard at growing it. We're sort of harvesting cash out of it. And if I'm honest, we look forward to the day when our predominant revenue stream is SaaS and that SaaS is a higher and higher percentage of revenue every year.

And there's a crossover point in the not too distant future for us. And so to the extent that we are able to kind of migrate some of the Marketing Services customers that land nicely onto our Marketing Center platform, we can say that a double win because we really have now moved them onto a modern platform where they get a much higher level of engagement and service, they get better value, and it speeds up the day that we do that crossover.

Operator

Our next question comes from the line of Rob Oliver with Baird.

Robert Cooney Oliver ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

Great. Joe, I had one for you and then Paul, I had a follow-up for you. So Joe, just on Command Center, it sounds like really encouraging trends here through the beta. I'm curious to hear just on the usage of Command Center, you guys had some tiered pricing out there for Command Center. And just curious what you're seeing within usage patterns and how that could play out in terms of where your customers may land in those tiered pricing plans?

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Well, as we said, it is still in beta. And it's early, but we're seeing people hook up a unified inbox and pull together all the different communications that are coming from different areas. And we're hearing things like I'm not missing messages anymore. I mean, who goes and always checks every one of your social outlets every day. It's kind of a laborious thing to do and it's pulling it all together into one place. And there are customers, not big numbers yet, very small numbers, but we've had some customers discover Command Center

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online, go and downloaded in sort of 60 seconds, start using it, say, wow, this is all really cool, move through and buy another center, like buy a business center, like move all the way through the process and self-upgrade and buy more stuff.

So it's really early, and there were some early little glitches and things during the beta period that we worked out. So we're super optimistic about what that will mean in terms of helping us meet new qualified customers, ideal clients in the future. So the numbers are very small of people that have self-upgraded and are buying, and we haven't sold anybody Command Center yet. But we're super optimistic about what it will look like as it comes off data, it becomes generally available, and we begin to actually promote it and tell people about it and spread the word.

Robert Cooney Oliver ***Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst***

And then, Paul, just curious if any revenue impact since it starts to go live this quarter was contemplated in your guidance relative to Command Center for the quarter?

Paul D. Rouse ***Thryv Holdings, Inc. - CFO, Executive VP & Treasurer***

Command Center, very little, but that's really something you're going to see more in the outyear period. It's really driven by the success of Marketing Center the optimism -- Marketing Center we have is the optimism in the fourth quarter.

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Yes, I'm just going to add a little tiny bit of that answer just for the whole audience. The -- because it's a freemium motion in Command Center, while we're excited about it, we don't see any revenue really this year. And even in the first half of next year, it will be a relatively slow ramp of revenue, not of users, we think users are going to go through the moon. And it's going to be a really powerful tool for us to enter new markets, meet new customers, kind of spread a blue ocean of excitement about what we're doing, but revenue will follow later because we want to deliver value to those customers before we ask them for any money. So it's not like some of the other centers where there were sales-driven motions where as soon as you rolled it out, you started selling it.

Operator

Our next question comes from the line of Zach Cummins with B. Riley Securities.

Zachary Cummins ***B. Riley Securities, Inc., Research Division - Equity Research Analyst***

Joe, I just wanted to ask a little bit more about Marketing Center. Can you just give us a sense of how much opportunity is left within the existing zoo? It seems like it's really been a focus in the near term, but just trying to get a sense of how much more runway there is to go in terms of adoption on that side?

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

A lot, a whole lot.

Paul D. Rouse ***Thryv Holdings, Inc. - CFO, Executive VP & Treasurer***

Yes. We've got nearly 400,000 customers. Right now, we've got [60-odd-thousand] that are buying some kind of center from us. There's a lot. I mean, I can't really think of a reason why over the balance of this decade, virtually all small businesses won't adopt some of these tools. And since they're our customer, and they have a relationship with us, the average has been with us for 15 years on average. Why wouldn't they give us a chance? Why wouldn't they talk to us? And so I'm quite bullish that we're going to be able to penetrate our way through that base. And I will tell you, approaching them with marketing-related products and services is easier than approaching them with a full business process change and they need to sign up for a CRM and really change the way they do business. It's easier this way.

Maybe we should have done them in a different order. I'm not sure, but it is what it is. But we're definitely getting more traction now. And I'm quite bullish that, that will carry through next year and you'll see zoo hunting as a bigger piece of the puzzle of customer acquisition. And relying less on outbound and inbound marketing and spending money to acquire customers just continues to drive better margins in the SaaS business as well.

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Zachary Cummins ***B. Riley Securities, Inc., Research Division - Equity Research Analyst***

And regarding the decision, the restructuring within Marketing Services that maintain more of those salespeople. Should we think of that as more of just a one-time margin impact here in Q4? Or what's the right way to think about that in terms of continuing to manage margins across the Marketing Services business?

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Yes. So if we kind of back the camera up a little bit and think about the big picture of what we're doing here, we are taking a Marketing Services business and we're running it on a harvest for cash. We're not really making any efforts to grow that business. And so if you think about over the last number of years you've been following the company, we've been variabilizing all the costs against Marketing Services, in advance of revenue decline.

So we sit down in the summer before 2023 and we map out what revenue is likely to be and it's incredibly projectable and predictable what those revenues are going to be. And we lay out what our cost should be to continue to deliver high margins. And so one of the #1 levers that we've used to variabilize the cost of the business is adjusting the number of feet on the street, how big that sales force is. So we're reaching a point -- kind of an inflection point now where Marketing Services and -- or excuse me, SaaS is getting to be a much, much bigger percentage of our overall revenue and carrying more overheads.

And so we actually have the luxury now of not necessarily shrinking that sales force into that number. And so there's a little bit of cost that you see show up in it, but we think that will quickly convert into stronger SaaS revenue as we go into the future. So, it's not so much adding anything, it's just slowing down the action that we've been taking. And directionally -- this is not meant to be specific guidance, but directionally, SaaS will be approaching 40% of revenue next year. And within the next bunch of quarters, actually cross over and become our predominant revenue stream.

And so we're looking more and more at how to grow our SaaS business as opposed to just how to manage margin on the Marketing Services business. It's really just kind of a transitory thing that's taking place inside the business. It's gradual. It's not all at once.

Operator

(Operator Instructions) Dan Moore with CJS.

Daniel Joseph Moore ***CJS Securities, Inc. - MD of Research***

Maybe just 1 or 2 others. Maybe this time last year, you kind of gave the outlook for Marketing Services EBITDA, given the change in the billing cycle. When we look to '24, how do we think about Marketing Services EBITDA relative to your '23 guidance under the current printing cycle?

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Well, there's a -- let's start with the printing cycle. Clearly, more books come back next year. So there'll be a little bit of a comeback in Marketing Services. That's on the good side and Marketing Services is continuing to perform in a reliable, steady Eddie way. I'll point you to our billings. You can look back many, many, many quarters and look at how consistently it performs.

Having said that, given the traction that we're getting with the new products that we're coming out with, we're feeling like we can go more aggressively into that zoo, not just doing add-on sales, but even a little bit of self-cannibalization. And so we're doing the work right now on what the '24 plan will be. And in our February earnings call, we'll guide you on what next year is going to look like. But I think directionally, we probably will be, as I mentioned before, growing the SaaS business a little faster and possibly modeling a little bit more of a decline in Marketing Services as we really cannibalize that ourselves and penetrate that ourselves.

And we think overall, that's a healthy thing, because rather than sitting and letting the iceberg just melt on its own, we're going in there with a real actionable product and we're moving people to a much higher engagement, much more modern platform. It's also helping us reduce costs on the other side of the business because as we move people over, we can wind down and turn off some legacy systems that

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they're on. So there's a lot of moving parts in this. But when I think about next year, I think about more books showing up in the pub schedule next year. So that's a good guide to Marketing Services, but maybe us leaning on it from cannibalization a little harder than we have in the past.

Daniel Joseph Moore ***CJS Securities, Inc. - MD of Research***

And I haven't seen -- if you put out a supplemental deck, I haven't seen it yet, so forgive me, but not seeing any change in that sort of 20% annual decline in billings at all?

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

We don't anticipate that, no. Cameron, do you have anything to add to that?

Cameron Lessard ***Thryv Holdings, Inc. - Assistant VP of IR & Treasury***

With the cannibalization, it might wave a little bit over time, but not --

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

Not into the future. Yes. And again, we're doing the work now on how much we think we can do next year and we'll be very communicative with you as to what that is. But I would expect we'll lean on Marketing Services a little harder in order to grow SaaS a little faster.

Operator

Our next question comes from Emily Needham with 400.

Joseph A. Walsh ***Thryv Holdings, Inc. - Chairman & CEO***

You can just end the call.

Operator

This concludes the Q&A session as well as the call. We thank you for your participation. You may now disconnect.

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