criteo

Q1 2019 Earnings Call | Prepared Remarks | April 30, 2019

Edouard Lassalle – VP, IR

Good morning and welcome to Criteo's first quarter 2019 earnings call.

With us today are co-founder & CEO JB Rudelle and CFO Benoit Fouilland.

During this call, management will make forward-looking statements. These may include projected financial results or operating metrics, business strategies, anticipated future products and services, anticipated investment and expansion plans, anticipated market demand or opportunities and other forward-looking statements. As always, such statements are subject to various risks, uncertainties and assumptions.

Actual results and the timing of certain events may differ materially from the results or timing predicted or implied by such forward-looking statements. We do not undertake any obligation to update any forward-looking statements contained herein, except as required by law. In addition, reported results should not be considered as an indication of future performance.

Today, we will also discuss non-GAAP measures of our performance. Definitions of such metrics and the reconciliations to the most directly comparable GAAP financial measures were provided in the earnings release published earlier today.

Finally, unless otherwise stated, all growth comparisons made in the course of this call are against the same period in the prior year.

With that, I now turn the call over to JB…

20 **JB Rudelle –** Co-founder & CEO
21 Thank you, Ed, and good morning everyone.
22
23 Looking at where we are after Q1, we see **a mixed picture**.
24
25 On one hand, we are making good progress with several key priorities. Our new solutions are
26 growing fast, we are shipping important product features and we are getting positive feedback
27 from clients testing our new solutions. In Q1, our topline grew above the high end of our guidance
28 and we significantly exceeded expectations for profitability. Overall, I feel good about **our**
29 **strategic direction** and our **financial model**.
30
31 On the other hand, I acknowledge that our topline growth is still way too modest relative to our
32 potential. I also realize that some of the new capabilities we are building to achieve our
33 transformation are going to **take more time** before yielding the acceleration we are working very
34 hard for. In particular, despite encouraging client performance from our new solutions, we are **not**
35 **ready yet to sell them in a truly scalable way**. To complete our transformation, we **have a few**
36 **execution issues to fix** to complete, more in a minute, and we believe it's going to take a bit
37 longer than expected to get the **full** benefit of it. While we are paving the way for acceleration in
38 2020, the issues we have identified lead us to **take a more modest approach to our 2019 growth**
39 **outlook**. As a result, we now expect Revenue ex-TAC growth to be in the range of flat to +2% in
40 2019. Despite this slow growth, we are **maintaining our profitability margin outlook** for the
41 year.
42
43 So, with this in mind, I'd like to address **three big questions** today:

44 • First, **why** are we more cautious in our outlook and **what** does that mean for 2019?
45 • Second, **what** are we doing about it?
46 • And third, **how** did we perform in Q1 and **where** are we going next?

47
48 Starting with **why** we are taking a more modest view for 2019. It relates to **delayed execution in**
49 **two well-identified areas**:

50 - One, our **ability to successfully sell our product suite at scale requires further expertise**
51 **building**. While we are shipping new features on time, we need to evolve the sales
52 organization and go-to-market further in order to grow these solutions even faster. This relates

53 primarily to our web upper-funnel and app-install products. In those two areas, the gap in
54 terms of sales pitch, client onboarding process and campaign management, as compared to
55 retargeting, is significantly larger than what we anticipated.

56 - Two, **our demand-generation programs for midmarket are not ready yet**. While our
57 technology for self-service onboarding will be ready on time at the end of Q2, as planned, we
58 realized that our demand-generation programs to attract new small clients in large numbers
59 will take until early 2020 to be fully effective in driving client additions at scale.

60

61 Given how significant the contribution of new products and midmarket small client sales were to
62 our **original** plans, those two factors combined account for a **material gap** compared to our prior
63 expectations for 2019. While it will take more time to see the business reaccelerate, I strongly
64 believe these two issues **can be fixed**.

65

66 So, **what are we doing** to address them? In both areas, we are working hard to make our **go-to-**
67 **market processes more scalable**.

68 - First, to **accelerate the sales growth of our new products**, we are focusing on three
69 initiatives: 1/ adapting our **Sales & Operations organization**, 2/ bringing **new sales**
70 **specialists** on board and 3/ doubling down on **training** our client-facing teams. In parallel,
71 we are adjusting our hiring and people onboarding processes to more effectively scale up
72 sales capabilities for upper-funnel products. In retrospect, while we understood that we
73 needed to adjust our go-to-market, we underestimated the time it takes to hire specific sales
74 experts in a very competitive market for talent. Effective May 1, we are also unifying all app-
75 install sales specialists **under a single management.** The intent is to create the right level of
76 focus and urgency in our organization. Overall, we expect these initiatives to start driving
77 tangible results **by early 2020**.

78

79 - Second, with respect to our **midmarket demand-generation programs**, we are also
80 grouping various initiatives under a **single senior executive** also effective May 1. These
81 initiatives include 1/ selling our solutions through **third-party sales channels**, 2/ integrating
82 with **Ecommerce Platform Partners** to make our solutions directly available to our clients'
83 on their ecommerce platform, and 3/ increasing our **own lead-generation programs** on
84 social media and other digital channels. We expect the implementation of our initiatives will
85 start to drive significant momentum in midmarket client additions in the **first half of 2020**.

Turning now to our **Q1 achievements**, we **made tangible progress on several priorities**.

First, our **new solutions** – which include all solutions **outside** of retargeting – grew 74% on a Revenue ex-TAC basis to 9% of total, this compared to 5% in Q1 last year. This momentum shows that our new product roadmap is moving in the right direction. However, for the reasons I mentioned before, we will experience a delay of a few quarters before this new growth engine contributes to our overall numbers at the level we originally expected.

As a reminder, the Criteo platform is comprised of two main components:

- On one side, **Marketing Solutions** that includes a self-service, an API and a managed platform to address the entire advertising funnel all the way from brand awareness campaigns down to conversion programs to generate sales;
- On the other side, **Retail Media** also includes a self-service, an API and a managed platform to power brand advertising revenues for retailers.

With respect to **Marketing Solutions**, we increased the performance of our Customer Acquisition product by 11% in Q1. Finding new prospects is a key ask from our clients and our improved performance drove Revenue ex-TAC for this product up 155%.
In **apps**, our business grew 32%. While this is solid, we were expecting significantly higher growth in apps in Q1. As discussed before, we are putting a plan in place to address this important point. On our product roadmap for apps, we made good progress for app-install, including the shipping of a new campaign optimization tool, publisher bidding and user scoring algorithms. These new features, all combined, drove performance improvements of 10% to 50% for our test clients. This is promising for a product that is still early but expected to bring significant contribution to our growth next year.

In our **Retail media** business, we also continued to make progress. In particular, our transactional-Saas offering for large retailers once again grew triple digits. This said, despite having all the technology pieces to become an **industry-leader, our momentum in Retail Media is not yet on par with our ambition.** To accelerate our execution, in March, we appointed Geoffroy Martin, former CEO of Art.com, as our new General Manager for Retail Media. Geoffroy brings a wealth of revenue generation expertise in the retail and technology space, combined with a strong

119 operational background and financial discipline. This senior appointment highlights our
120 commitment to bring our Retail Media business to the next level.
121
122 In Q1, we also shipped several important features for our **client self-service platform.** These
123 allow clients to "turn the dials" themselves and have more control over their marketing operations.
124 Q1 shipments included a whole suite of rich analytics tools providing clients with full transparency
125 on where and how their campaigns are performing. We also introduced self-service support tools,
126 so clients can self-repair broken campaigns much more easily. And the most significant module
127 we introduced a month ago is the ability to design and launch, in full self-service mode, new
128 marketing audiences covering multiple advertising scenarios. We tested this module with 3,000
129 advertisers in the U.S. and the U.K. In the first month, over 60% of their Consideration campaigns
130 were created and managed entirely in self-service mode, a very encouraging signal.
131
132 Still talking about our platform, I am also pleased to confirm we are on track to ship our **self-**
133 **register onboarding module** for new small and medium clients by the end of Q2, as planned. As
134 discussed earlier, we anticipate it will take until early 2020 to fully implement the related demand-
135 generation programs and reaccelerate the pace of our client net additions.
136
137 Now moving to the **supply side**. Our ability to bid the optimal price for each impression has always
138 been one of Criteo's distinctive strengths recognized by the industry. I am pleased that we further
139 improved the performance of our critically important first-price bidder in Q1. In parallel, our Direct
140 Bidder continues to make good progress. The growth is mostly driven by mobile apps where 135
141 app developers are now working with our technology, an increase of 70% compared to the
142 previous quarter.
143
144 Finally, on the **talent front**, employee morale improved in Q1 and we saw unwanted attrition slow
145 down across the organization. This trend illustrates a good alignment of our people with Criteo's
146 strategic direction and priorities.
147
148 Before closing, I'd like to say a few words about **user identity**. Recently, a media outlet speculated
149 about Google's intention to make potential changes to third-party cookies in the Chrome browser.
150 We already addressed this topic on our last earnings call and, compared to what we discussed
151 three months ago, nothing new had happened in the industry. However, given the negative

152 pressure these speculations have put on our stock price, I feel it's worth to reiterate our position.
153 Given the **intense scrutiny Google faces from antitrust authorities globally**, we believe it is
154 unlikely they would take advantage of Chrome's dominant position in the browser market to restrict
155 the ability of other digital players to compete.
156
157 In closing, **where are we going next**?
158
159 Despite making significant progress on our roadmap, we recognize that 2019 is **another**
160 **transition year** for Criteo. Yet, despite slower growth, we **maintain our profitability margin**
161 **outlook** for the year. While our investments will lead to a few points of deleverage this year, we
162 believe the actions we are taking will drive a **higher profitability margin** next year.
163
164 We are **confident in our strategic direction** and are **100% focused on execution** to support
165 our future.
166
167 With that, I'll now turn the call over to Benoit.
168

Benoit Fouilland – CFO

Thank you, JB, and good morning to everyone from my side. As usual, I will walk you through our performance for the quarter and share our guidance for Q2 and fiscal year 2019.

Revenue grew 3% at constant currency to $558 million.

Revenue ex-TAC, our key metric to monitor the business, increased 2% at constant currency to $236 million. Existing clients adopting our new solutions as well as new client business drove our growth in the quarter despite some continued short-term headwinds.

Changes in currency negatively impacted Revenue ex-TAC by $11 million or 4.4 points of growth compared to Q1 2018. Compared to our guidance assumptions, FX changes were immaterial.

Revenue ex-TAC margin declined 40 basis points to 42%, in line with our expectations that margin would normalize at a lower level compared to the peaks we saw in the first half of 2018.

Looking at our **main growth drivers** for the quarter:

- We **grew the number of clients by 5% to over 19,000,** while maintaining retention at close to 90% for all solutions combined. As we **increased** our focus on higher-value midmarket clients until we launch our self-register onboarding module, this resulted in lower client additions in the quarter.
- Same client Revenue ex-TAC was down less than 1%. However, on a **revenue** basis, which truly reflects our clients' spend with us, **same-client revenue increased 2%**, demonstrating the growing adoption of our new solutions by existing clients.

Turning to the **regional performance**.

- In **the Americas**, Revenue ex-TAC grew 8% at constant currency, including **8% in the U.S.** This was driven by the growing number of existing clients adopting new solutions, accelerated growth in the midmarket, good performance of Retail Media in the U.S., as well as improving performance of our Brazilian business.
- **EMEA** Revenue ex-TAC decreased 2% at constant currency despite solid growth of our new Consideration solutions as well as accelerated growth in our midmarket business, partly offset by continued short-term headwind related to GDPR implementation.

202 • And, in **APAC**, Revenue ex-TAC grew 3% at constant currency, driven by strong results in
203 Korea, our growing business with several large clients in Japan, and healthy improvement in
204 midmarket, in part offset by slower business in India and South-East Asia.
205
206 Shifting to **expenses. Other cost of revenue** decreased 13%, driven by gains from a sale of
207 decommissioned servers and lower depreciation expense as we extended the useful life of our
208 servers from 3 to 5 years. This was partly offset by a provision for the new digital tax on revenue
209 introduced in Italy and France, and higher expenses for third-party data to complement our
210 shopper graph.
211
212 **GAAP Operating expenses** were flat year-over-year. The increase in headcount costs was fully
213 offset by lower equity awards compensation expense due to the lower stock price over the period.
214
215 **Headcount-related expenses** represented 74% of GAAP OpEx, down 3 points compared to the
216 prior-year period. We ended the quarter with over 2,800 employees – an increase of 5% year-
217 over-year.
218
219 On a Non-GAAP basis, operating expenses increased 2% to $150 million. Looking at these
220 expenses by function:
221 • **R&D** expenses increased 1%, driven by a 5% increase in headcount to over 700 R&D and
222 Product engineers.
223 • **Sales & Operations** expenses were flat despite a 4% increase in headcount to just shy of
224 1,600, slightly higher than expected. Quota-carrying employees, comprising sales and account
225 strategists, grew 3% to over 720.
226 And **G&A** expenses increased 9%, in line with a 9% increase in headcount to over 500
227 employees. Adjusting for exceptional items, namely the gain on the HookLogic travel business
228 disposal last year as well as one-time accounting and tax advisory fees this year, Non-GAAP
229 G&A expenses actually decreased 1%.
230 For 2019, we now expect Non-GAAP expenses to **grow more modestly** across all functions than
231 originally expected.
232
233 On the **profitability** side, **Adjusted EBITDA** was $69 million, 13% above the high end of our
234 guidance, and 6% below Q1 2018 at constant currency. This drove our Adjusted EBITDA margin

235 to 29.2% of Revenue ex-TAC, down 320 basis points. In Q1 last year, Adjusted EBITDA was
236 **unusually** high due to proceeds from the sale of the HookLogic travel business and lower
237 expenses as we were significantly behind our hiring plans a year ago. Just adjusting for the sale
238 of the Travel business, Adjusted EBITDA margin was down only 280 basis points.
239
240 **Depreciation and amortization** expenses decreased 18%, mainly driven by the change in the
241 useful life of our servers from 3 to 5 years.
242
243 **Equity awards compensation expense** decreased 28% due to the lower stock price.
244
245 **Financial expense** increased 49%, largely due to the impact of changes in forex rates on our
246 hedging positions.
247
248 And, our effective **tax rate** was 32%, in line with our projected tax rate of 30% for 2019 adjusted
249 for negative discrete items related to the lower stock price. This compares to a 37% effective tax
250 rate in Q1 2018. As a result, the provision for income taxes decreased 19%.
251
252 **Net income** increased 1% to $21 million, driven by the lower tax expense, partially offset by a
253 4% decrease in Income from Operations and higher financial expense.
254
255 On a Non-GAAP basis, **earnings per diluted share** were flat at 60 cents.
256
257 **Cash flow from operations** decreased 20% to $67 million, driven by the lower Adjusted EBITDA,
258 unfavorable changes in working capital and increased taxes paid. Despite this, our transformation
259 of Adjusted EBITDA into operating cash flow was strong at 97%.
260
261 **Capex** decreased 27% to $24 million, representing 4% of revenue.
262
263 As a result, **Free Cash Flow** decreased 16% to $44 million, reaching 63% of Adjusted EBITDA.
264
265 Finally, **cash** and cash equivalents increased $31 million in the quarter to $396 million.
266

267 With regards to **capital allocation**, we are requesting a new authorization at our shareholder
268 meeting in two weeks to increase our flexibility to execute share buy backs in the future.
269
270 I will now provide our **guidance** for the second quarter and fiscal year 2019. The following
271 forward-looking statements reflect our expectations as of today, April 30, 2019.
272
273 Given the slow start into Q2 and the delays we are experiencing in execution, we are taking a
274 **more cautious approach** to our quarterly and full year Revenue ex-TAC outlook.
275 As a result, for Q2, we expect Revenue ex-TAC **between $221 million and $224 million** on a
276 reported basis. This implies constant currency growth of -2% to 0%. We expect year-over-year
277 forex changes to be a headwind of about $5 million or 230 basis points to the reported growth.
278
279 For the full year 2019, as JB indicated, **we now expect Revenue ex-TAC to grow between 0%**
280 **and +2% at constant currency**. Using our current forex assumptions, this means Revenue ex-
281 TAC of approximately $950 million to $969 million. Compared to our prior guidance, this is a
282 **reduction of about 3%** at the midpoint. Compared to 2018, forex changes are expected to have
283 a negative impact of about $16 million or 170 basis points of reported growth.
284
285 On the profitability side, we expect Q2 2019 Adjusted EBITDA **between $50 million and $53**
286 **million**. Adjusted for temporary savings and exceptional items of approximately $6 million in the
287 prior-year quarter, this translates into a margin dilution of approximately 390 basis points.
288 For 2019, given our softer topline outlook, we will increase our focus **on effective cost**
289 **management** to ensure we deliver on our profitability goals in 2019 and take the adequate
290 actions to drive an increase in profitability margin next year. We therefore **maintain** our
291 expectation of an Adjusted EBITDA margin of **approximately 30% of Revenue ex-TAC** for 2019,
292 demonstrating our commitment to profitability.
293
294 As usual, FX assumptions supporting our guidance for the second quarter and fiscal year are
295 included in our earnings release.
296
297 In closing, I reiterate our **confidence** in the **clear direction of our strategy** and in the **strength**
298 **of our financial model**.
299

300 With that, we will now take your questions.

301

302 *[…Q&A…]*

303

304 **Edouard Lassalle** – VP, IR

305 Thank you, JB and Benoit. This concludes today's call and we thank everyone for attending. The
306 IR team is available for any follow-up questions you may have. Good bye everyone and enjoy
307 the rest of your day.