August 2, 2023

Criteo Q2 2023 Earnings Call | Prepared Remarks

Melanie Dambre – VP, Investor Relations

Good morning, everyone and welcome to Criteo's second quarter 2023 earnings call.

Joining us on the call today, Chief Executive Officer Megan Clarken and Chief Financial Officer Sarah Glickman are going to share some prepared remarks. Todd Parsons, our Chief Product Officer, will join us for the Q&A session. As usual, you will find our investor presentation on our IR website now, as well as our prepared remarks and transcript after the call.

Before we get started, I'd like to remind you that our remarks will include forward-looking statements, which reflect Criteo's judgment, assumptions and analysis only as of today. Our actual results may differ materially from current expectations based on a number of factors affecting Criteo's business. Except as required by law, we do not undertake any obligation to update any forward-looking statements discussed today. For more information, please refer to the risk factors discussed in our earnings release, as well as our most recent Forms 10-K and 10-Q filed with the SEC.

We'll also discuss non-GAAP measures of our performance. Definitions and reconciliations to the most directly comparable GAAP metrics are included in our earnings release published today.

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

With that, let me now hand it over to Megan.

Megan Clarken – Chief Executive Officer

Thanks Melanie and good morning, everyone. Thank you all for joining us today. I'm pleased to report that we delivered a strong performance in the second quarter, driven by our team's outstanding execution despite ongoing macro-economic volatility.

We have demonstrated resilience in the current environment, and despite the market factors, we are where we said we would be: in the pole position and at the center of the commerce media ecosystem. We believe that we're uniquely equipped to provide market leading tech to our clients, prospects and partners who are looking to capitalize in one of the fastest growing areas of digital advertising – Commerce Media.

Our transformation to a Commerce Media powerhouse continues to unfold and our Commerce Media Platform vision is coming to life. One year after the acquisition of Iponweb, we've successfully completed the integration of our teams and we're leveraging the Iponweb assets to accelerate our strategy. This includes the imminent launch of our Demand Side Platform called Commerce Max, and the launch of our Supply Side Platform called Commerce Grid. These capabilities bookend our stack and the differentiation that they bring unlocks the full potential of our Commerce Media Platform and positions Criteo to become an end-to-end platform of choice for Commerce Media.

Starting with Commerce Max, we look forward to the general availability of our Commerce DSP next month. Stay tuned for more details on the official launch on September 12th. Our beta testing has progressed well with various retailers and brands across multiple geographies. As we expected, results of our beta testing show increasingly strong results in terms of conversion rates on integrated onsite and offsite campaigns. This proves the value to our clients of the advantage that the end-to-end platform delivers. We're very encouraged by our growing pipeline of retailers and brands that have already signed up to use Commerce Max, and we expect the ramp up to be gradual over the coming quarters. Brands and agencies are excited to finally have a single access point to buy premium Retail Media inventory onsite and open Internet inventory offsite while also taking advantage of differentiated features like closed-loop measurement and product-level sales data, and leveraging unique audiences built on real shopping behaviors to drive performance. Retailers are also excited to leverage Commerce Max to best monetize their onsite inventory and their valuable first-party data to increase their revenue and bring more shoppers to their sites.

Moving on to Commerce Grid, we're pleased with the successful launch of our Commerce SSP. Omnicom was our launch partner, and we have since expanded access to other agency holdcos in the U.S. and EMEA. We've combined our Criteo direct supply with Iponweb's capabilities to create a unique value proposition for the market.

For the first time, Commerce Grid brings our Commerce Audience data, like shopper intent signals, in audience segments which publishers can package with their inventory. For retailers, Commerce Grid brings additional monetization opportunities. It allows retailers to curate their first party audiences and make them available for access through all DSPs. Importantly, Commerce Grid expands access to third-party demand so that agencies and brands can reach commerce audiences through any DSP. Commerce Grid is both complementary and supplemental to Commerce Max, making our Commerce Media Platform interoperable to drive incremental demand, mainly from agencies that have already committed spend to other DSPs. For agencies, this can be a first step to participate in Retail Media, and they will leverage Commerce Max to access sponsored listings onsite and real-time campaign optimization for both onsite and offsite with closed loop reporting.

Ultimately, it all contributes to attracting more demand to our platform, and increasing advertising revenue for media owners. This is the power of the Commerce Media Platform, allowing data flows and client access across one platform.

Turning to our second quarter performance, we're pleased with our growing momentum as we continue to shift towards a broader solution portfolio centered on the fast-growing Commerce Media opportunity. Our New Solutions now represent around half of our top-line and we expect this will become the larger part of our mix going forward, as we laid out at our investor day.

Our Q2 performance also demonstrates our strong focus on execution as we continue to do what we said we will do.

Starting with Retail Media, we bring our 7 years of experience to a growing number of retailers – now 210 retailers, 2,400 brands and our agency partners globally. We're pleased to see that our Retail Media growth has accelerated in our third quarter to date as we're ramping up newly signed partnerships.

We're proud to win the trust of an increasing number of retailers across all our regions. We're also expanding our footprint with online marketplaces, including most recently Debenhams and Sprinter who chose Criteo for our superior technology and monetization opportunities.

We're making great strides into adjacent commerce verticals, as exemplified by our Uber partnership. Through our platform capabilities, CPG brands can now promote their brand and products via sponsored ads on the Uber Eats' app in multiple countries. We're pleased with the continued ramp up of this exciting partnership, and we have ambitions to launch additional formats and markets in the coming months.

More broadly, we are scaling our existing retailer relationships and this quarter launched new inventory with seven top U.S. and EMEA clients to help them expand their monetization opportunities.

Our access to unique and premium Retail Media inventory at scale has been instrumental in attracting more demand. We added nearly 100 new brands in Q2, and Retail Media spend driven by agencies grew over 50% in the U.S. this quarter. Our agency partners are increasingly leaning into Criteo as we're independent, meaning we don't own any media, we're not a retailer and we're not part of any agency. We are independent. They also value the tools we bring to maximize performance for their brands. This includes our unique AI-powered digital shelf analytics providing visibility into their share of shelf, share of category, and more product-level insights as part of our DSP. Only Criteo applies AI to digital retail shelf analytics and we were granted a US patent on Systems and Methods including the integration of AI for Digital Shelf Display earlier this year. It's still very early days, but we're already seeing top brands harness the power of these insights to strategically design campaigns to win or defend market share.

Looking now at Marketing Solutions, we delivered strong growth in Commerce Audiences as we continue to diversify our business by combining large-scale commerce data and breakthrough AI technology to power relevant advertising in environments deprived of third-party signals. Commerce Audiences represented close to half of our Contribution ex-TAC from new clients in Q2, up from only a third of our new business a year ago. This reflects our ability to unlock targeting opportunities in signal-limited environments that others cannot address, leveraging our large-scale commerce data and AI-powered audience modeling tech to find in-market shoppers. Commerce Audiences are the most valuable audiences to brands and an integral part of our Commerce Media strategy. These capabilities also create the foundation for our success in Retail Media offsite as we help retailers extend their advertising reach beyond their own walls across the open internet.

Importantly, we've made great strides in cross-selling our solutions with about 100 more clients now using more than one Criteo solution, compared to last quarter. Clients like Currys are embracing the power of our Commerce Media platform and now leveraging our suite of always-on customer acquisition and retention solutions in addition to our Retail Media capabilities.

Retargeting benefited from our latest release of AI-driven performance enhancements to optimize campaigns and unlock additional budgets in a still uncertain macro-economic environment.

In addition, we continue to scale our First-Party Media Network to retarget consumers with first-party data matching in cookie-less environments. We saw a sequential increase in hashed email bidding this quarter and results are encouraging. A top U.S. publisher partner saw an immediate lift of close to 140% in CPMs for Safari browser traffic, which contributed to a year-on-year increase of 70% in media spend, after enabling hashed emails as a targeting signal for its authenticated, logged-in users. This demonstrates that our publishers can have confidence around continuity for when third-party cookies are deprecated on Chrome and Android.

As part of our multi-pronged addressability strategy, we also remain one of the largest scaled partners in the Privacy Sandbox. Google's recent announcement of scaled testing with 1% of Chrome users for the web before the planned deprecation of third-party cookies is a positive development in line with our recommendation to get real-world results. It is also expected to represent an integral part of the UK CMA's assessment. We believe that Criteo leaning into a close collaboration with Chrome to develop specific use cases will enable us to deliver superior performance.

Last quarter, we shared our thoughts on the potential for Generative AI to reshape advertising and I would like to provide an update on what that means for Criteo. Unlike others in the industry, we have privileged access to the largest commerce dataset on the open internet. We leverage twice as much e-commerce sales as Amazon with more than $1 trillion every year, or close to $3 billion in daily transactions, to fuel our commerce-driven AI models. Thanks to our Criteo AI Lab's expertise, our models incorporate Deep Learning at scale, and combined with our consented commerce data, deliver breakthrough performance across the entire buying journey. We are integrating Generative AI into our platform with a focus on three specific areas:

- improving performance,
- enhancing the user experience for our clients and their customers shopping online, with applications such as chatbot interactions for product recommendations, and,
- optimizing our service delivery process through co-pilots to drive efficiencies.

Our clients are at the center of everything we do, and client retention remained high at close to 90%. The meaningful year-over-year improvement in our average customer satisfaction score is a testament to the hard work of our teams. We are focused on bringing value to our clients through service and performance with a client centricity lens to everything that we do. Our CSAT score this year was the highest it has been in three years.

Criteo is working across the industry to establish standards for Retail Media that we expect will help encourage further adoption and drive long-term growth for the ecosystem. One example of particular importance to me is measurement. Measurement is an imperative for advertisers to make data-driven decisions, demonstrate value and ultimately achieve better results. Brands also need to compare results across marketing channels to create benchmarks. Recognizing this need, we're leading the way with a first-of-its kind partnership with Integral Ad Science to bring industry standard viewability and invalid traffic measurement on any onsite ad format across our network of retailer partners. It is expected to unlock new budgets from advertisers that adhere to strict media buying standards.

To conclude, our focus on execution is front and center at every level of our organization. We believe we've built a highly scalable Commerce Media Platform and we're confident in our future. We're focused on profitable growth, and we have multiple initiatives underway to generate operating leverage over time, all with a focus on driving shareholder value.

With that, I will now turn the call over to Sarah, who will provide more details on our financial results and our outlook.

Sarah Glickman – Chief Financial Officer

Thank you, Megan, and good morning, everyone. Our second quarter performance reflects our clear focus on performance and execution.

Revenue was $469 million and Contribution ex-TAC was $240 million. Reported Contribution ex-TAC reflects a year-over-year $2 million unfavorable forex impact.

At constant currency, our second quarter Contribution ex-TAC grew by 13%, on top of 7% growth in Q2 2022. Our organic performance was flat and driven by Marketing Solutions down -5% year-over-year, with Retargeting down -15% as expected, offset by Commerce Audiences growth of 41%. Retail Media was up 20% year-over-year, and Iponweb contributed $29 million.

We continue to shift our top-line mix to our fast-growing new solutions for Retail Media, Commerce Audiences and Iponweb that represented around half of Contribution ex-TAC in our second quarter. Our client retention at 90% continues to be resilient, and we had great new client wins this quarter.

Turning to our business segments, in Retail Media, revenue was $45 million and Contribution ex-TAC grew 20% at constant currency to $44 million, and was up 62% on a two-year stack basis in a traditionally low quarter. This was primarily driven by our client base in the U.S. and our online marketplaces, offset by lower spend in France due to temporary government measures to curb inflation. In Q2, we added 10 retailers and 100 brands, and our same-retailer Contribution ex-TAC retention was 118%. We also saw strong growth from our agency partners, and robust brand bookings, mainly in CPG, our largest vertical. As we anticipated, our Retail Media growth rate accelerated in July.

In Marketing Solutions, revenue was $395 million and Contribution ex-TAC was $168 million with strong growth in Commerce Audiences, offset by lower Retargeting. As expected, Retargeting was down 15% year-over-year, or down 12% when excluding the $4 million impact from signal loss. Our clients continue to operate in a choppy economic retail and consumer environment with significant focus on their marketing investments. In the second quarter, Retail online traffic and online transactions improved sequentially. However, Retail online transactions were lower across all regions in Q2 compared to last year. Our Travel vertical is performing well, up 36% in Q2, and 111% on a two-year stack basis. The optimization of campaign performance with strong ROAS using our deep learning algorithms and advanced vector database technology unlocked more budgets as we progressed through the quarter.

We delivered strong growth in Commerce Audiences, up 41% year-over-year, and up 62% on a two-year stack basis, as more clients transition to full-funnel audience strategies to acquire and retain customers. As we capitalize on cross-selling opportunities, we see that our clients value having one partner to help them engage with consumers across their entire buying journey.

One year after completing the acquisition, we have successfully integrated Iponweb which has been instrumental in accelerating our Commerce Media Platform strategy. On a stand-alone basis, Iponweb's performance was up mid-single digit in a seasonally low quarter.

We delivered an Adjusted EBITDA of $56 million in Q2 2023. Non-GAAP operating expenses increased 6% year-over-year primarily due to Iponweb, partially offset by our planned cost reduction actions. A key part of our transformation is to realign our organization and optimize our operating model to enable scale and operational efficiencies. We have already executed against the majority of our targeted cost savings this year, and we continue to streamline our processes to work better and faster.

Moving down the P&L, Depreciation and Amortization increased 32% in Q2 2023 to $27 million. Non-cash share-based compensation expense increased to $28 million, including $11 million related to treasury shares granted to Iponweb's founder as part of the acquisition. We incurred restructuring costs of $22 million, offset by the partial reversal of the CNIL contingency. Combined with the margin dilution from Iponweb in a seasonally low quarter, these factors resulted in a net loss of $2 million in Q2 2023. We reported a diluted net loss per share of $0.05 and adjusted diluted EPS of $0.49.

We have a strong financial position with solid cash generation and no long-term debt. We had $747 million in total liquidity as of the end of June, which gives us significant financial flexibility to execute our growth and capital allocation strategy. As expected, Free Cash Flow was negative by $35 million year-to-date due to capex related to the planned 5-year renewal cycle of our data centers and restructuring. We anticipate positive free cash flow generation in the second half of the year in line with the seasonality of our business including Retail Media and Iponweb. We expect the CNIL payment in Q3 which will impact our Free Cash Flow in Q3.

The primary goal of our capital allocation is to invest in high ROI organic investments and value-enhancing acquisitions and to return capital to shareholders via our share buy-back program. We deployed $75 million of capital for share repurchases in the first half of 2023. This included 0.7 million shares repurchased in Q2 at an average cost of $32.3 per share.

Turning to our financial outlook, which reflects our expectations as of today, August 2nd. We remain cautiously optimistic about our outlook for the remainder of the year, and we anticipate high-single-digit to low-double-digit Contribution ex-TAC growth at constant currency in 2023.

This assumes low-single-digit organic growth and the full year impact from our acquisition of Iponweb. We now expect Contribution ex-TAC growth of 25% to 30% for Retail Media reflecting the first half performance and unchanged expectations for growth for the remainder of the year. For Commerce Audiences, we expect Contribution ex-TAC growth of 25% to 30% as advertisers continue to shift more budgets and adopt full-funnel activation. We do not expect signal loss impact in the second half of the year. Overall, as a reminder, we expect more pronounced seasonality with Q4 as our business mix is evolving.

We continue to anticipate an Adjusted EBITDA margin of approximately 28% for 2023, including about 200 basis points of dilution from Iponweb. We are on track to deliver over $60 million in annualized cost savings over the course of the year, largely offsetting the annualized impact of our 2022 growth investments. Given seasonality, we expect approximately 45% of our full year Adj. EBITDA to be realized in Q4.

We expect a normalized tax rate of around 25% in 2023. We anticipate capex of about $90 million, mainly related to the planned renewals of our data centers, for which most spend has incurred in the first half of the year. For modelling purposes, we assume a flat number of shares outstanding in 2023.

As we enter the second half of the year, we are ready for back-to-school and the holiday season, and we are seeing Retail Media brand spend accelerate. Overall, we expect Q3 Contribution ex-TAC of $238 million to $242 million, growing by 7% to 9% at constant currency. This assumes low to mid-single-digit organic growth and one month of Iponweb inorganic growth.

We estimate forex changes to drive a positive year-over-year impact of about $8 million to $10 million on Contribution ex-TAC in Q3.

We expect Adjusted EBITDA between $58 million and $62 million, reflecting the dilution from Iponweb.

Looking ahead, we remain focused on executing our transformation to drive long-term shareholder value. This includes operational excellence initiatives across all aspects of our business. Capitalizing on our pole position in Retail Media, our priority is to enable sustainable growth and margin expansion as we continue to scale our Commerce Media platform. The future is wide open for Criteo.

With that, I'll turn it over to the operator to begin the Q&A session.

[…Q&A…]

Melanie Dambre – VP, Investor Relations

Thank you, Megan, Sarah and Todd. This now concludes our call for today. Thanks everyone for joining. The IR team is available for any additional requests. We wish you all a good day.