Q2 2016 Financial Results Conference Call – Prepared Remarks

Edouard Lassalle - Head of Investor Relations

Good morning everyone. Welcome to Criteo's second quarter 2016 earnings call.

With me today are CEO Eric Eichmann and CFO Benoit Fouilland.

During the course of 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. These 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.

Also, we will discuss non-GAAP measures of our performance. Definitions of these metrics and the reconciliations to the most directly comparable GAAP financial measures, are provided in the earnings press release issued earlier today.

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

With this, I will now turn the call over to our Chief Executive Officer, Eric Eichmann.

<u>Eric Eichmann – CEO</u>

Thank you Edouard. Good morning everyone. I am pleased to report another strong quarter of profitable growth. We continue to execute consistently on our plans for both growth and operating leverage.

Before diving into the quarterly earnings, let me take a few moments to explain Criteo's vision in a fast changing advertising landscape.

We believe that **data-driven, people-centric marketing that is held accountable to performance metrics** is the way all advertising will be done in the future. The era of not knowing which half of a marketer's advertising spend is working will be a thing of the past.

Three big trends are accelerating this transition:

1. Mobile is driving the digitization of offline activities, making offline intent data available and offline sales trackable
2. One-to-one marketing at scale, based on accountable metrics, is growing fast and
3. Increasingly, marketers are demanding optimization and coordination of their marketing activities across channels and devices

We are well positioned to help marketers make this transition and finally **make all advertising work**. Through our solution, consumers experience more relevant ads across channels and devices and clients get superior performance. And our continued innovation in core technology, mobile and cross-device are driving higher value for clients.

Turning to Q2. We exceeded Revenue ex-TAC and Adjusted EBITDA guidance for the **eleventh consecutive quarter**. At constant currency, we grew Revenue ex-TAC 35% to $166 million and Adjusted EBITDA 61% to $39 million. We continue to make progress toward our long-term operating model, demonstrating the scalability and leverage of our business.

We performed well **across all areas**:

- We delivered on our **innovation roadmap**.
- We continued to **expand our publisher relationships**.
- And we **added a record number of new clients** across all regions.

Technology innovation drives more client sales every quarter. Q2 2015 clients generated 14% more Revenue ex-TAC at constant currency in Q2 2016, in line with our expectations. Keep in mind that this metric is based on clients that were live any day during the last twelve months to Q2. Whereas advertisers that were live in both Q2 last year and Q2 this year, generated 20% more Revenue ex-TAC at constant currency. 77% of our business comes from uncapped budgets, helping drive same-client growth. Three areas are worth mentioning in technology and product innovation:

1. We continue to perform well on **mobile** which represents over half of our business. Commerce on mobile devices is growing for our clients and represents 40% of their ecommerce transactions. Our full solution positions us well to take advantage of the rapid shift to mobile commerce. Mobile app commerce continues to enjoy strong momentum with advertisers, generating conversion rates of up to 3x those of mobile web. Our app business grew almost six fold compared with last year, accelerating from last quarter, and now drives a meaningful share of mobile growth.

2. Client adoption of our **Universal Match** technology remains strong. As commerce becomes more and more fragmented across devices, advertisers increasingly need seamless solutions across different consumer touchpoints. 66% of our advertisers share anonymized CRM data which enables us to grow our cross-device graph. This pooled cross-device graph becomes stronger as we scale, benefiting from network effects. Matched users represented 47% of Revenue ex-TAC.

3. We **continue to innovate across the core platform**. We are making good progress in building the infrastructure to leverage our large-scale cross-device graph within the recommendation and prediction layers of the Engine. We are also developing new versions of the Engine: one to optimize our clients' gross margin and the second one to allow them to bid on a target cost of sales. We released a new prediction model driving efficiency around post-click sales that resulted in meaningful uplift in Revenue ex-TAC. And we deployed new dynamic creative features for advanced image management and image cropping to create even more engaging ads for consumers.

Shifting now to **publisher relationships**. We added over 1,200 publishers bringing us to over 17,000 direct publisher relationships in our network, providing us with a strong advantage.

Around 6,000 advertisers are now live on **Facebook** dynamic ads on both mobile and desktop, with another 500 ready to go live. The dynamic ads product is performing well for our clients and we continue to see further potential to optimize it in partnership with Facebook. In addition, many advertisers are now live on **Instagram**, a new source of social inventory for us.

In **native**, we continue to enjoy very positive traction, as native inventory is growing quickly among publishers. Revenue ex-TAC from native outside of Facebook grew close to 50% quarter-over-quarter. Our strengths in flexible integration and dynamic creative capabilities position us well to drive further native growth. We started to roll out our direct-to-publisher native ad solution and expect a larger scale deployment in the coming quarters. We signed and expanded partnerships with several native platforms including Yahoo! Gemini. We also extended our partnership with Taboola, and now buy several ad slots at the same time compared to only one previously.

And we further expanded our **mobile app reach**, in particular in app-heavy Asian markets. We launched Twitter's Mopub across APAC and included mobile app in our partnership with Baidu in China and mobile with Kakao in Korea. We launched eight new RTB platforms and are excited about the strong pipeline of new app inventory.

Now moving to **client additions**. With over 900 net new clients, we set a new record, ending Q2 with close to 12,000 clients. And we maintained client retention at 90% for the 20th consecutive quarter.

We signed new large and midmarket clients across all regions. Midmarket contributed to over three quarters of client additions this quarter. **Midmarket remains a significant opportunity** for us, with a penetration of less than 15%. To accelerate the launch of midmarket campaigns, we continue to roll out a set of automation tools. Our feed module, which allows for automated integration of our clients' product catalog with our servers, went live in Q2. By early 2017, we intend to deploy the complete range of self-service tools from registration and tagging, to product feed, creative and payment.

Turning to **regional performance**. We delivered consistent execution across all geographies.

The Americas grew Revenue ex-TAC 38% at constant currency and was the largest contributor to our global growth. Midmarket growth remains healthy across the region at close to 70% year-over-year, despite a demanding hiring environment for sales people. Brazil remained a tough geography for large clients as a result of the difficult political and macro context in that region.

Revenue ex-TAC in **EMEA** grew 25% at constant currency. Established markets continue to post solid growth, in particular Germany. We signed several new large clients including Telecom Italia, and a global apparel group based in Spain. Travel clients further expanded their business with us across many markets in EMEA.

Finally, **APAC** Revenue ex-TAC grew 50% at constant currency. Momentum is very solid across markets. New business was strong, in particular in Japan and India. We opened our legal entity in India in Q2 and signed several large advertisers. These include India's largest ecommerce marketplace; India's fashion ecommerce giant Jabong; and MakeMyTrip, India's largest online travel agent. Growth across South-East Asia was close to 80%. We continue to make progress developing our domestic business in China. And we hired Yvonne Chang, a high-caliber leader with strong industry expertise, as head of APAC.

In addition, we further strengthened the global leadership team with Tom Aurelio as Head of HR and Elie Kanaan as Head of Marketing, both with a strong technology background.

Looking to the second half of 2016, we remain focused on a **clear set of priorities**:

- First, continue to **innovate on the core platform**, in particular building the infrastructure to leverage our cross-device graph within the Criteo Engine.

- Second, **expand into further sources of inventory**, especially mobile, social and native.

- Third, **strengthen our position in APAC**, in particular in South-east Asia, India and China.

- Finally, **develop new products**, especially in paid search.

We will be happy to share more about future growth opportunities and progress on new product initiatives, including search, at our upcoming **Investor & Analyst Day** in San Francisco on September 15. We hope to see you there!

In closing, I'm pleased with our strong Q2 performance, delivering high growth and improving profitability. We are executing in line with our plans and have exciting new products in the pipeline. As advertisers demand more relevant, accountable and seamless marketing, we believe we are best positioned to address their needs in the coming years.

With that, let me turn the call over to Benoit Fouilland, our CFO.

Benoit Fouilland – Chief Financial Officer

Thank you Eric and good morning everyone. I am also pleased with our strong performance in Q2. Fast growth and expanding profitability remain key attributes of our business model.

I will walk you through our quarterly financial performance and our guidance for Q3 and 2016.

Revenue was $407 million, up 36% or 35% at constant currency.

Revenue ex-TAC, the key metric we use to monitor our business performance, grew 36% or 35% at constant currency to $166 million. This was driven by the impact of the largest quarterly addition of new clients as well as sustained growth of existing clients' spend, in line with our expectations. Revenue ex-TAC margin was 40.8%, consistent with prior quarters.

We grow midmarket very fast and the share of midmarket clients continues to increase. At constant currency, **average Revenue ex-TAC per live client** increased over 10% and 13% for large clients and midmarket respectively.

Compared with guidance assumptions, **changes in forex** had a positive impact of $0.7 million on reported Revenue ex-TAC, mostly driven by a stronger Japanese Yen. Compared with the prior-year period, forex represented a tailwind of 140 basis points to reported growth in Revenue ex-TAC, also largely driven by the stronger Yen.

Turning to expenses. **Other cost of revenue**, comprised of hosting and data costs, was $20 million. Non-GAAP other cost of revenue grew 49% to $11 million, mainly driven by increased hosting capacity across data centers.

Operating expenses were $128 million. Non-GAAP operating expenses grew 27% to $116 million. **Headcount-related** expenses represented over 75% of Non-GAAP opex. We added 110 net new employees and closed the quarter with over 2,080 employees, a 27% increase compared to June last year.

On a Non-GAAP basis by function:

- **R&D** expenses grew 60% to $27 million, largely driven by the 46% growth in headcount to approximately 470 employees.
- **Sales & Operations** expenses grew 16% to $65 million, also largely driven by the 21% increase in headcount to over 1,250 employees. Quota-carrying headcount grew 21% to 570, with 70% of the growth coming from midmarket.
- **G&A** expenses increased 32% to $25 million, while headcount grew 28% to 360 employees.

Adjusted EBITDA grew 66% or 61% at constant currency to $39 million. Adjusted EBITDA margin for the quarter was 9.6% of revenue or 23.6% of Revenue ex-TAC. As a percentage of Revenue, this is a 170 basis point improvement. This was driven by a significant 270 basis point leverage in Sales & Operations while investing 100 incremental basis points of revenue into R&D for future innovation. During the first six months of 2016, we improved profitability by 150 basis points of revenue compared with H1 2015. This demonstrates the scalability and leverage in our model and I'm pleased that our improved profitability is tracking well in line with our midterm operating target.

Financial income improved by $2.5 million to close to nil. This increase was driven by the conversion of intragroup debt with our Brazilian subsidiary into equity and the removal of cash hedging costs related to that position, in line with the indications provided on our last call. Going forward, we will not incur any hedging costs in the financial income related to Brazil.

Net income increased 240% to $13 million, driven by the 128% growth in income from operations and the significant improvement in financial income over the period. The effective tax rate for the quarter was 25%, based on our estimated annual effective tax rate, which includes the recognition of deferred tax assets in the U.S. Adjusted EPS on a diluted basis increased 106% to $0.33.

Cash flow from operations grew 61% to $19 million, despite the significant negative impact of working capital changes and an increase in income taxes paid over the period. While we maintain DSOs in a healthy level of mid-50 days, we continue to be prudent with regards to credit risk in certain geographies, given the breadth of our global footprint.

Capex increased 22% to $22 million. This represented a sequential increase of 85%, mainly driven by new data center equipment, in line with our investment plan for the year.

Free cash flow improved 51% to negative $3 million, despite the negative impact of the change in working capital and increased capex over the period.

Finally, **total cash** and cash equivalents were $377 million at the end of June, up $24 million from December 31, 2015.

Last but not least, I will now discuss our **guidance**. The following forward-looking statements reflect our expectations as of today, August 3, 2016.

We expect Q3 2016 Revenue ex-TAC to be **between $170 million and $174 million**. This would imply a growth at constant currency of between 27% and 30%. We do not expect changes in forex to materially impact our reported growth in Q3.

And we expect Q3 2016 Adjusted EBITDA to be **between $42 million and $46 million**.

Forex assumptions underlying the Q3 2016 guidance are included in the earnings release we published earlier today.

Consistent with the more stable guidance framework for the full year that we discussed on our last two earnings calls, we **reiterate** our financial outlook for fiscal 2016, as provided on February 10, 2016:

We expect Revenue ex-TAC for fiscal 2016 to **grow between 30% and 34% at constant currency**. We anticipate changes in forex to have a negative impact of 115 basis points on our reported growth for the full year.

And we expect fiscal 2016 Adjusted EBITDA margin as a percentage of revenue to **improve between 60 basis points and 100 basis points** compared with fiscal 2015.

In closing, I am pleased with our continued strong performance in Q2, combining fast growth with increasing profitability. I am particularly satisfied with our progress on operating leverage while we continue to invest in future innovation. I am excited and confident about the outlook for 2016.

I look forward to providing more details of our financial profile during our **Investor & Analyst Day** in San Francisco on September 15, and hope to see many of you there. Please remember to register with our IR team.

With that, let me now turn the call back to the operator to take your questions.