CRITEO

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Criteo Q1 2023 Earnings Call | Prepared Remarks

Melanie Dambre – VP, Investor Relations

Good morning, everyone and welcome to Criteo's first 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. We're off to a solid start this year and our team is firing on all cylinders to execute on our transformation strategy and capitalize on the significant growth opportunity ahead of us.

Our transformation continues to shift our business towards a broader solution portfolio, centered on the fast-growing Commerce Media opportunity. Our Commerce Media platform puts the focus on both our Retail Media expertise and our expanded Targeting solutions with Commerce Audiences complementing Retargeting, which remains the lower funnel tactic enjoyed by marketers. Commerce Media represents a market opportunity of $110 billion by 2025, and it's real. The agency holdcos have now all created dedicated commerce teams to capitalize on the momentum, and 73% of advertisers anticipate spending more on Retail Media Networks in the next two years than they are today, according to a recent survey from the U.S. Association of National Advertisers.

Notwithstanding the near-term challenging macro-economic environment, our trajectory is intact. In Q1, we delivered continued strong growth in Retail Media and Commerce Audiences, which, combined with Iponweb, more than offset some of the pressures we've seen in Retargeting. While Retargeting remains an area of continued focus and opportunity, our New Solutions have now become close to half of our top line and will become the larger part of our mix going forward. This is exactly where we wanted to be at this stage of our transformation.

We're quickly gaining share and laying the ground for sustainable, long-term growth. Starting with Retail Media, we now partner with 200 retailers and 2,300 brands, and we're expanding our reach into adjacent commerce verticals and geographies. No other player matches our market footprint, and our global presence gives us a significant competitive advantage.

We secured the renewal of our multi-year exclusive partnership with Costco. As the third largest retailer in the U.S. and one of the largest retailers in the world, Costco has significant room for growth in Retail Media, and we're very excited to help them scale and realize this massive potential. We also won new retailers including ASOS, Rite Aid and Sundrug in Japan, strengthening our leadership in fashion, health and beauty. Our ability to scale quickly with our proven demand capabilities, AI-driven performance and support from Retail Media experts were among the deciding factors in the decision of these retailers to partner with Criteo.

We've built a leading platform for retailers to manage their entire Retail Media business at scale. The ASOS and Rite Aid wins illustrate the power of our holistic value proposition, and both have chosen us for multi formats and placements, including onsite sponsored products and display, and offsite and, like most others, they have taken multi-year contracts. It's no coincidence that more retailers are choosing Criteo as their exclusive Retail Media partner for the long-term. We've worked with Retailers for a very long time and understand their needs, we've built deep expertise in Retail Media over the past 7 years, and this is what we focus on every single day.

Agencies are increasingly contributing to our growth, and we're confident that this will continue. An increasing number of brands, including most recently PepsiCo, are shifting from competitors to Criteo to access Retail Media Networks at scale due to our superior performance, customer service, and enhanced data analytics. Other brands such as Haleon are increasing their annual investments upwards of 75% in most part due to strong Return On Ad Spend and partnership.

Looking now at Marketing Solutions, we delivered strong growth in Commerce Audiences as more clients are adopting full-funnel strategies to acquire and retain customers. Commerce Audiences are an integral part of our Commerce Media strategy and create the foundation for our success in Retail Media offsite, as we help retailers extend their advertising reach beyond their own content walls. Our AI-powered audience modeling tech finds in-market shoppers based on interests, demographics, location, brand and product affinity or lookalike modeling. We leverage prospecting audiences to engage new consumers in any environment, agnostic of third-party identifiers. PUMA is one of our new clients that has recently adopted our Commerce Audiences targeting solutions to engage the audiences that matter most to them.

We're also proud of our growing global partnership with one of the world's largest marketplaces who's leveraging the depth and breadth of our offering to drive performance across multiple channels including video and CTV. With full-funnel activation, they more than tripled their media spend with Criteo compared to a year ago, with Commerce Audiences now representing 90% of their media spend. Similarly, the travel marketplace Viator doubled their media spend with Criteo year-over-year with full-funnel activation. Our clients value our best-in-class performance, which is further amplified when engaging with consumers across the entire buying journey.

Our Retargeting results in Q1 reflect the impact of a difficult macro-economic environment on our clients, especially our retail and long-tail clients, partially offset by continued strength in Travel. We're seeing caution and more frequent budget reforecasting compared to prior years, leading to lower spend this quarter.

It's important to note that we're about half-way through our multi-year transformation. Despite the choppy macro backdrop, we continue to do what we said we would do, and we're working hard to execute against our plan. We've made great strides in bringing our Commerce Media Platform to life while building long-term trusted relationships with retailers and executing strategic partnerships to accelerate our strategy.

Starting with our growing agency relationships, we saw a 56% year-over-year increase in U.S. Retail Media spend driven by the major agencies we have strategic partnerships with, and our momentum with agencies continues to accelerate. Agencies are driving 35% of our overall media spend, and adoption of our multiple solutions at speed and scale.

We currently activate about $1 billion in annual Retail Media spend, and we believe the launch of our Commerce Max Demand Side Platform will be a game changer. Commerce Max gives agencies and brands one integrated self-service platform to access premium Retail Media inventory onsite, with both sponsored and display placements, and leverage unique third-party audiences built on real shopping behaviors for precision targeting offsite. It offers closed-loop measurement across open internet supply as well as retailers' inventory onsite. For the retailers, Commerce Max is the platform to best monetize their onsite inventory and their valuable first-party data for onsite and off-site targeting with access to demand coming from agencies and brands.

The integration of Iponweb accelerated the launch of our DSP, and following our initial successful market tests, we're now partnering with half a dozen retailers and multiple brands, and we continue to see strong results. Our clients are excited about what we're bringing to market, and we're leveraging their feedback to add more features and functionality. This gives us a differentiated product as we build momentum in Commerce Media. We're on track to move to general availability in Q3, and we expect Commerce Max to help us capture more agency and brand budgets, and drive further growth in Retail Media through the offsite advertising opportunities that it unlocks.

Importantly, we continue to advance our moat and differentiation. Omnichannel is emerging as the next frontier, and we're empowering retailers to own their entire Retail Media ecosystem across physical and digital stores. With the acquisition of Brandcrush, we now provide an omnichannel retail media monetization platform and we can tap further into traditional trade marketing dollars. Our platform not only centralizes online and offline retail media inventory management, but also creates greater efficiencies for the retailers who otherwise rely on manual processes to manage these assets. We're best positioned to address this market need as evidenced by the success of recent pitches including the Brandcrush capabilities. Our goal is to help retailers take full advantage of their media opportunity, and to solidify our Retail Media leadership position for years to come.

The acquisition of Brandcrush also expands our client footprint and capabilities in the rapidly growing Asia-Pacific Retail Media market, where we added 18 retailer clients over the past year including 4 wins in Q1 alone. We now have 5 Retail Media clients in Japan, from a standing start, and we're actively capitalizing on cross-selling opportunities. In the region, we're also pleased with the ramp up of our offsite partnership with Flipkart, India's homegrown e-commerce marketplace.

Turning to our Commerce Growth offering, our second demand side product designed to automate our audience targeting and retargeting capabilities. A great example of how we plan to extend the reach of this self-service offering is our partnership with Shopify. We recently rolled out new self-registration capabilities allowing all Shopify merchants to quickly set up their account and start activating their campaigns with Criteo. Our Shopify merchant clients value the ease of use of our targeting tools and the performance we're driving to turbocharge their business.

Lastly, we're pleased with the progress that we're making on our multi-pronged identity strategy under the helm of Todd Parsons, our Chief Product Officer, and Dr. Boris Mouzykantskii, our Chief Architect. We continue to scale our First-Party Media Network to retarget consumers with first-party data matching in cookieless environments. As part of this direct supply strategy, we've more than doubled our traffic leveraging hashed emails since last October. Hashed emails are persistent IDs and foundational across our First-Party Media Network. Among others, Slate.com, CafeMedia and A360media are now partnering with us to monetize their inventory more effectively. This has led to a meaningful spend increase in Safari for our publishers. When looking at signals from publishers we have direct integrations with, we collect 10 times more hashed emails than similar alternative industry IDs.

To support this work, we have now fully integrated our Criteo supply capabilities with Iponweb's capabilities – taking the best of both into our Commerce Grid Supply Side Platform, or SSP.

As part of the multiple investments we've made in our identity strategy, we've also been working side by side with Google for a long time, and we remain one of the largest scaled partners in the Privacy Sandbox. Our product and R&D teams have had an ongoing series of in-person workshops with Google, and we're very encouraged by the productive collaboration and results to date as we continue to test and inform their APIs. We believe that Criteo leaning into a close collaboration with Chrome to develop specific use cases will enable us to deliver superior performance. Privacy Sandbox is an ecosystem effort, which means our investments are contributing to how the advertising industry at large needs to evolve for privacy.

There's a lot of buzz right now about the potential of generative AI to reshape advertising. Based on what we know today, we look to four main areas of impact. First, like all AI technologies, we believe it will drive better performance for those who have access to data through better use of that data. Second, the ability to have rich interactions with end users will likely change how people search online by being able to engage in conversational exchanges with AI chatbots. Third, the assistance it provides could enhance how advertisers are creating, managing and optimizing their advertising campaigns – particularly around creative where the change could be profound. And fourth, the tools and efficiencies that it creates. The most important point is that AI can only make a difference with access to data at scale. At Criteo, we believe we have the largest commerce data set on the open internet. We observe millions of buyer journeys each minute, predicting how they'll unfold. We use our huge data set to predict consumer behavior and how ads will perform and convert. The combination of our highly advanced AI technology and access to more than one trillion in ecommerce sales every year is what allows our solutions to drive the best performance for our clients.

To conclude, we've built a highly scalable Commerce Media Platform, and we're on track to achieve our business ambitions that we laid out at our 2022 investor day. In 2023, we believe we're best positioned to lead the market with Retail Media being a non-cyclical growth spot, and Commerce Audiences being the most valuable audiences to brands.

Our ongoing progress wouldn't be possible without our incredible Criteos. I'm very proud of our team's collective efforts and hard work. We continue to transform our company to realize our vision while navigating a challenging environment.

As we transform our business, we're focused on driving efficiencies while allocating our resources to our growth areas. We hold ourselves accountable to deliver growth, expand our operating leverage, and deploy capital effectively and in a disciplined manner, 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 first quarter performance reflects our clear focus on execution and cost discipline.

Revenue was $445 million and Contribution ex-TAC was $221 million. Reported Contribution ex-TAC reflects a year-over-year $10 million unfavorable forex impact.

At constant currency, Q1 Contribution ex-TAC grew by 6.3%, on top of 6% growth in Q1 2022. As expected, this includes organic Contribution ex-TAC down -5%, and Iponweb. Our organic performance was driven by Marketing Solutions down -10% year-over-year, with Retargeting down

-17%, and Commerce Audiences up 27%. This was partially offset by continued strong growth in Retail Media, up 22%, despite a tough comparison and a seasonally low quarter.

We continue to shift our top-line mix to our fast-growing new solutions. Retail Media, Commerce Audiences and Iponweb combined represented 44% of Contribution ex-TAC in our first quarter, up from 29% a year ago. Client retention remains high at close to 90%, and, 37% of our live clients use more than one Criteo solution today.

Turning to our business segments, in **Retail Media**, revenue was $38 million and Contribution ex-TAC grew 22% at constant currency to $37 million, in line with our expectations, and was up 70% on a two-year stack basis. Our growth was primarily driven by our client base in the U.S. and the UK, as well as our retailer marketplaces. Growth from existing clients remains strong with same-retailer Contribution ex-TAC retention at 122%, and we continue to win new retailers. We also saw strong growth from our agency partners. Our 2,300 global brands are prioritizing Retail Media as a key channel to advertise to consumers at the digital point of sales across multiple Retail Media Networks. We saw strong brand bookings, mainly in CPG, our largest vertical, and health and beauty.

In Marketing Solutions, revenue was $382 million and Contribution ex-TAC was $158 million with strong growth in Commerce Audiences, offset by lower Retargeting. Retargeting was down 17% year-over-year, or down 12% when excluding the impact of the suspension of our Russia operations and the expected $4 million impact from signal loss. Across all regions, we benefitted from strength in Travel. Retail was impacted by the macro-economic environment, which remains challenging as evidenced by the lower online traffic and lower online transactions across the majority of retail categories in the Americas and EMEA in Q1.

We delivered strong growth in Commerce Audiences, up 27% year-over-year, and up 61% on a two-year stack basis, as clients transition to full-funnel audience strategies to acquire and retain customers. This was driven by new business and cross-selling across thousands of performance marketers. Our clients value having one partner to help them engage with consumers across their entire buying journey, which we believe will drive higher media spend and enhance client lifetime value over time.

As expected, Iponweb's performance was down slightly on a stand-alone basis in a seasonally low quarter. Strong growth for our Supply Side Platform, or SSP, was offset by softer media trading trends and lower traffic. We are pleased with the rapid and seamless integration of that business.

We delivered an Adjusted EBITDA of $39 million in Q1 2023. Non-GAAP operating expenses increased 14% year-over-year, largely driven by Iponweb and targeted growth investments in sales, R&D and product talent, partially offset by planned cost reduction actions. Importantly, we lowered our expense run rate in Q1 compared to Q4, including headcount reductions, discretionary spend controls and other efficiency initiatives. We have already executed against many of our targeted cost savings and continue to ensure strong resource allocation measures and cost discipline across the business.

Moving down the P&L, Depreciation and Amortization increased 14% in Q1 2023 to $25 million. Share-based compensation expense increased to $26 million, including $10 million related to treasury shares granted to Iponweb's founder as part of the acquisition. The dilution from Iponweb in a seasonally low quarter and the non-cash share-based compensation expense related to the stock component of the acquisition resulted in a net loss of $12 million in Q1 2023. Our weighted average diluted share count was 60.5 million compared to 63.6 million last year. This resulted in diluted net loss per share of $0.20 and adjusted diluted Earnings Per Share of $0.46 in Q1 2023.

We benefit from a strong financial position with solid cash generation, no long-term debt and blue-chip bank relationships. We had $814 million in total liquidity as of the end of March, which gives us significant financial flexibility to execute our growth and capital allocation strategy. Operating Cash Flow was $42 million and Free Cash Flow was $9 million in Q1, reflecting planned capex investments related to the 5-year renewal cycle of our data centers as we transition to a more cost and energy efficient data center architecture.

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 as we continue to see attractive value in repurchasing our shares. In Q1, we repurchased 1.7 million shares at an average cost of $29.9 per share.

Turning to our financial outlook, which reflects our expectations as of today, May 3rd. We remain cautious about our outlook for the remainder of the year given the ongoing volatility in the macro-economic environment, but we remain confident in our trajectory towards 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 continue to expect Contribution ex-TAC growth of approximately 30% for Retail Media. For Commerce Audiences, we expect Contribution ex-TAC growth of approximately 20% as advertisers continue to shift more budgets and adopt full-funnel activation.

Looking at the cadence for the year, we expect stronger organic growth as we lap the impact of the suspension of our Russia operations in March 2022 and easier comparisons in the back half of the year. We also expect to benefit from the ramp up of recent retailer partnerships and the continued rollout of our Commerce Media Platform capabilities and features. As our business mix is evolving, we expect more pronounced seasonality with Q4 including Iponweb's strongest quarter and expected high growth in Retail Media. Lastly, our outlook incorporates our expected front-end loaded signal loss impact of $10 million and currency headwinds in 2023.

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. We expect approximately half of our full year Adj. EBITDA to be realized in Q4 given business seasonality with Iponweb and realization of our expected cost savings. In addition to our top line growth engine, a key part of our transformation is to realign our organization and optimize our operating model to enable scale and operational efficiencies, with strong profit contribution from all our products. This includes streamlining our processes and leveraging our assets to work better and faster, and ensure best-in-class client experience while **driving meaningful operating leverage over the coming years**.

We expect a normalized tax rate of 28% to 30% in 2023. We anticipate capex of about $90 million, mainly related to the planned renewals of our data centers, of which most spend is expected in the first half of the year. We expect free cash flow conversion rate of about 45% of Adjusted EBITDA. For modelling purposes, we assume a flat number of shares outstanding in 2023.

For Q2 2023, we remain cautious given the impact of a slower macro environment on consumers, our clients, and conservative ad budgets. Overall, we expect **Q2 Contribution ex-TAC of $228 million to $234 million, growing by 8% to 10% at constant currency**. This assumes low-single-digit organic decline and Iponweb inorganic growth. As a reminder, Q2 is a seasonally low quarter for Iponweb in terms of Contribution ex-TAC, adjusted EBITDA and cash contribution. Importantly, we expect Retail Media and Commerce Audiences to continue to show robust growth. We estimate forex changes to drive a negative year-over-year impact of about $3 million to $5 million on Contribution ex-TAC in Q2.

We expect **Adjusted EBITDA between $46 million and $50 million,** reflecting low Q2 seasonality exacerbated by the dilution from IPONWEB.

To conclude, we are committed to driving shareholder value. We have a resilient business model, and we are executing our transformation with rigor and discipline. We have built a highly scalable

Commerce Media platform to enable sustainable growth and support margin expansion over time. 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.