November 2, 2023

Criteo Q3 2023 Earnings Call | Prepared Remarks

Melanie Dambre – Vice President, Investor Relations

Good morning, everyone and welcome to Criteo's third 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 another solid quarter with top line and adjusted EBITDA above our expectations driven by organic growth acceleration, market share gains in Retail Media, and strong cost discipline. Our performance is a testament to our team's hard work and the trust of our clients who continue to prioritize performance and rely on our solutions to drive sales and return on ad spend.

We've embarked on a significant transformation journey since I joined Criteo four years ago, and we've successfully moved our business from a single solution retargeting play to a multi solution platform offering end-to-end AI-enabled AdTech services with a focus on Commerce. We've demonstrated resilience, and we're now positioned at the forefront of the changes in our industry, all while navigating the impacts of signal loss, the global pandemic, geopolitical conflicts and a volatile macro-economic backdrop. Our unique commerce data at scale, deep integration with retailers, differentiated technology, advanced AI, world-class team, and R&D powerhouse have been the foundation of our strategy to become the leading AdTech provider for Commerce Media, the fourth wave in digital advertising.

Since our investor day one year ago, we've continued to focus our business on areas of high growth and expanded our leadership position in Commerce Media. We've maintained a high say/do ratio, and built the only unified, AI-driven platform that directly connects advertisers with retailers and publishers to drive commerce on retailers' sites and the open internet. Over the past twelve months, we've successfully integrated our acquisition of Iponweb, and brought our Commerce Media Platform to life for our clients. We further expanded our partnerships with agencies, retailers and supply partners, just as we said we would. We're well on our way to delivering over a billion dollars in Contribution ex-TAC this year for the first time in Criteo's history, including over 200 million dollars in Retail Media alone where we have a leading market footprint.

We've achieved a number of important milestones since we unveiled our Commerce Media platform vision last year. Let me highlight some of these achievements since then and during the third quarter.

Starting with Retail Media and our self-service Commerce Max Demand Side Platform which became generally available in September. We're the first to unify the Retail Media ecosystem with a multi-retailer, multi-channel, and multi-format approach. We believe our deep integrations with retailers ensure accuracy and fidelity of the data to execute against what the market is looking for:

fully integrated capabilities to advertise to shoppers at the digital point of sale across multiple Retail Media Networks, and to leverage unique retailer audiences built on real shopper data for targeting offsite with full funnel closed loop measurement. It's just the beginning, but we've already received strong feedback from our partners, including GroupM, Flywheel and Dentsu, and their brands.

Agencies and brands are increasingly leaning into Retail Media as the most effective closed-loop marketing investment, tying an ad directly to a sale. In addition to driving incremental sales, Retail Media helps brands better understand who is buying their products, what type of shopper prefers their brands and who those shoppers are that enter their category. The Retail Media spend going through our platform grew 39% this quarter, as we've grown our footprint to 2,500 brands, and agencies are increasingly contributing to our growth. Overall, the large agency holdcos have increased their Retail Media spend with Criteo by 50% so far this year in the U.S. and doubled their spend in Europe and APAC, compared to the same period last year.

At our *Retail Media For All* event in September, we also shared more about Commerce Yield, our retailer monetization solution suite that offers flexibility for retailers and marketplaces to monetize their online, offline, and in-store assets. We now partner with 220 retailers after adding 10 new retailers in Q3, and we've more than doubled the number of countries we operate in over the past year. We're proud to have won the trust of an increasing number of retailers globally including, most recently Saks, DocMorris, and Mercatus. In addition, we had two exciting new wins this quarter. They are two of the largest U.S. retailers. We will announce these when we're able to. We're pleased to now be the partner of choice for close to 60% of the top 25 U.S. retailers that have a monetization program.

We're pushing ahead to drive unification with advertising ecosystem-based solutions and standards across multi-retailer, multi-marketplace, and multi-commerce environments. We've been actively investing in key areas of measurement and insights with the aim to deliver an even more impactful set of solutions for brands and their agencies to reach their full potential with Retail Media. This includes partnering with industry leaders, such as trusted measurement provider Integral Ad Science. With this, brands can be assured their media buys are being seen, their ads are reaching real users across any onsite ad format, and that they are measured using industry standards so that they can compare results. While measurement is important, Insights and Analytics are critical navigation needs for clients and a differentiator for Criteo because of both our access to such extensive datasets, and our patented AI-powered digital shelf analytics. We're empowering Retail Media businesses with our Commerce Insights offering to better inform monetization strategies and drive larger brand investments. Walmart Connect Mexico is successfully leveraging these insights and almost tripled brand spending in Q3 compared to last year.

It's still early days for most of our clients, but we're excited to see that retailers and brands are increasingly taking advantage of the compelling Retail Media opportunity. Over the past year, the average number of retailers that brands are advertising on has increased by over 60% across our client base.

Next up, let me talk about how we've been accelerating growth in our supply business since the successful launch of our Commerce Grid Supply Side Platform, or SSP, in June. Commerce Grid had a great debut and is quickly gaining share. Our Commerce Grid SSP represents another path for us to capture incremental commerce media budgets from established DSPs. We're already seeing incremental demand from top agency holdcos for our proprietary commerce audience and supply packages, and we're excited to expand this opportunity to retailer audiences as we're about to launch our first campaign leveraging retailer data for audience extension across the open internet through Commerce Grid. This represents a powerful Digital Advertising shift for advertisers looking to engage with real shoppers, and a growth opportunity for 2024.

Moving on to Marketing Solutions, more clients are activating always-on strategies to acquire and retain customers using our Commerce Growth suite of services. As a reminder, "always on" refers to a service where advertisers commit a spend with us to drive the best results the best way we see fit. As we have evolved beyond Retargeting, that spend is optimized for our clients up and down the advertising funnel. In this context, we're excited by the continued traction of Commerce Audiences to complement Retargeting as marketers are looking for more touchpoints with consumers across their buyer journey to drive performance. Our investments are paying off, as our clients are leveraging a broader and richer audience set from targeting new shoppers who resemble existing high-value customers to finding relevant shoppers with contextual targeting or engaging shoppers who are actively researching the products and services that they offer. Our ability to target highly relevant and valuable in-market audiences is helping us gain ground against competitors that provide less precise targeting on the open internet. In addition, we expanded our partnership with Shopify as the first open internet platform integrated into the Shopify Audiences product. Shopify Plus merchants can now instantly upload first-party audiences of high, medium and potential intent generated by Shopify, and then activate campaigns with Criteo. This opens up opportunities to attract new Shopify Plus merchants that haven't used our solutions before and may consider using Criteo alongside Meta, Google, Pinterest, TikTok or Snap.

Lastly, we're encouraged by our prospects to extend our commerce value proposition to Meta. We've demonstrated our ability to drive incremental performance to our existing open web campaigns when accessing Meta's large-scale inventory and powerful communities. Following successful testing, we have an opportunity to extend the reach of our campaigns on Facebook and Instagram for hundreds of clients in Q4 and beyond.

As a testament to the power of our platform play, we've seen an acceleration in upselling and cross-selling dynamics with 38% of our clients now using more than one Criteo solution compared to 33% a year ago. Within Marketing Solutions, clients that have embraced the full power of our acquisition and retention solutions spent on average 30% more than a year ago in Q3, and this momentum is continuing. These dynamics have contributed to rebalancing our top line mix, with Retargeting now representing less than half of our business for the first time ever this quarter.

A critical part of our transformation is to lay the foundation for the future. This includes AI-driven innovation to fuel future growth, and our multi-pronged addressability strategy to enhance our resilience post third-party identifiers.

We have privileged access to the largest commerce dataset on the open internet to feed our AI models, and we continue to integrate Generative AI into our platform with a focus on improving performance and user experience for our clients, and optimizing our service delivery process. We're planning to offer AI-powered creative tools like intelligent image generation to clients to enhance performance. In Retail Media, we're focused on bringing sponsored ads into conversational environments as more consumers are utilizing chatbots on retailer websites. Internally, we're using AI to empower our sales team to drive more effective new client leads and enhance client experience through faster response to inquiries.

Turning to our multi-pronged addressability strategy, we're focused on three pillars to succeed in environments deprived of third-party signals, including our first-party data strategy, our participation in Google's Privacy Sandbox, and also our access to more closed and authenticated environments like retailers' sites and social platforms.

First, we continue to progress on scaling our First-Party Media Network to retarget consumers with consented first-party data-matching in cookie-less environments. Remember, we collect significantly more hashed emails, or HEMs, than similar alternative industry IDs, which means that we can leverage hashed emails as interoperable match keys to connect demand and supply across our network, and we're pleased to see HEM bidding increase every quarter. This is a crucial advantage to effectively find and monetize commerce audiences on the open internet once the industry finally moves beyond third-party signals.

Second, we remain one of the largest scaled partners in the Privacy Sandbox to which we've dedicated significant time and resources. Early next year, we plan to assess the effectiveness of the Privacy Sandbox APIs when Google phases out third-party cookies for 1% of Chrome users for the Web. The real-world results will be critical to further assess the economics associated with the Privacy Sandbox solution, its scalability, and the industry's readiness to absorb the significant changes and technical complexity.

Third, our differentiation lies in our ability to help our clients reach consumers in closed and authenticated environments like retailers' sites and social platforms. Our extensive partnerships with our retailers enables privileged access to first-party data for hundreds of millions of monthly users, and we're potentially expanding our reach to billions of logged-in users on social platforms or other environments where we expect to participate in the future.

To conclude, we believe we're better positioned than we've ever been before to drive performance for our clients across the entire marketing funnel. According to a recent Forrester survey, 90% of retailers say demand from advertisers for Commerce Media has increased significantly during the past 12 months, as there is nothing better than advertising at the digital point of sale or accessing in-market shoppers.

We're about to enter a critical year for digital advertising and our primary focus will be to deliver performance and continuity for our clients, while continuing to invest in our growth areas to scale our Commerce Media Platform. It's important to acknowledge that our path won't be linear, but we believe we've built a strong moat through a combination of unique and proprietary technology, commerce data and retail expertise to navigate the significant changes ahead of us, and capitalize on the next wave of digital advertising and indeed, the future of digital advertising.

With that, I will hand it over to Sarah to discuss our financial results and our outlook.

Sarah Glickman – Chief Financial Officer

Thank you, Megan, and good morning, everyone. Our third quarter performance reflects our strong execution despite a mixed macro-economic environment.

Revenue was $469 million and Contribution ex-TAC was $245 million. Reported Contribution ex-TAC reflects a year-over-year $5 million favorable forex impact.

At constant currency, our third quarter Contribution ex-TAC grew by 13%, on top of 14% growth in Q3 2022. This includes organic growth of 8%, driven by strong growth in Retail Media, up 29%, and a return to growth in Marketing Solutions, up 1% year-over-year at constant currency. Within Marketing Solutions, Commerce Audiences was up 31%, partially offset by Retargeting being down 7%, as expected. Iponweb contributed $34 million.

We continue to shift our top-line mix to our fast-growing new solutions for Retail Media, Commerce Audiences and Iponweb that represented 51% of our Contribution ex-TAC in our third quarter. Our client retention at 90% remains resilient.

Turning to our business segments, in Retail Media, revenue was $50 million and Contribution ex-TAC grew 29% at constant currency to $48 million. Our growth was primarily driven by our client base in the U.S. and our retailer marketplaces. In Q3, we added 10 retailers and 100 brands, and our same-retailer Contribution ex-TAC retention was up sequentially to 123%. We also saw strong growth from our agency partners, and robust brand bookings, mainly in CPG, our largest vertical, as brands shift more spend to digital channels. The Retail media spend we activated in Q3 grew 39% year-over-year, above market growth, demonstrating that we continue to gain share.

In Marketing Solutions, revenue was $386 million and Contribution ex-TAC was $163 million with strong growth in Commerce Audiences, offset by lower Retargeting. While Retargeting was down 7% year-over-year, it improved sequentially as the integration of our deep learning algorithms and advanced vector database technology into our recommendation engine has helped marketers enhance campaign performance. Our clients continue to operate in a choppy economic retail and consumer environment with scrutiny on their advertising dollars. That being said, our Retail vertical improved sequentially, and our Travel vertical continues to perform well, up 35% year-over-year in Q3, and above 100% on a two-year stack basis.

We delivered strong growth in Commerce Audiences, up 31% year-over-year, or 60% on a two-year stack basis, driven by cross-selling dynamics as our clients value having one partner to help them engage with consumers across their entire buying journey.

Iponweb's performance was up double digits on a stand-alone basis, primarily driven by accelerated growth for our Commerce SSP.

We delivered an Adjusted EBITDA of $68 million in Q3 2023. Non-GAAP operating expenses increased 5% year-over-year, due to Iponweb, partially offset by our cost reduction actions. As we transform our business, we continue to drive cost efficiencies while allocating resources to growth areas. We are on track to deliver higher cost savings, closer to $70 million, given our rigorous focus on cost management and efficiencies, largely offsetting growth investments.

Moving down the P&L, Depreciation and Amortization increased 28% in Q3 2023 to $25 million. Non-cash share-based compensation expense increased to $24 million, including $7 million related to treasury shares granted to Iponweb's founder as part of the acquisition. Our weighted average diluted share count was 60.2 million. This resulted in diluted earnings per share of $0.12 and adjusted diluted EPS of $0.71 in Q3 2023.

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 September, which gives us significant financial flexibility to execute our growth and capital allocation strategy.

As expected, Free Cash Flow was $4 million in Q3 due to the CNIL payment of $43 million. We anticipate significant free cash flow generation in the fourth quarter in line with the seasonality of our business including Retail Media and Iponweb.

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 $103 million of capital for share repurchases in the first nine months of 2023. This included 0.9 million shares repurchased in Q3 at an average cost of $30.4 per share.

Turning to our financial outlook, which reflects our expectations as of today, November 2nd. As we enter the last and largest quarter of the year, we remain cautious in our planning given the significant uncertainties in the macroeconomic and geopolitical environment. We saw muted trends in October, including softer media trading and lower traffic for Iponweb. That being said, as we move to the holiday season, our teams are actively engaged with our clients to deliver strong results. Overall, we expect Q4 Contribution ex-TAC of $296 million to $302 million, growing by 5% to 7% at constant currency.

We estimate forex changes to drive a negative year-over-year impact of about $2 million to $4 million on Contribution ex-TAC in Q4 given the weakening of the Euro and Yen against the U.S. dollar.

We expect Adjusted EBITDA between $109 million and $115 million.

For the full year, we now anticipate Contribution ex-TAC growth of approximately 9% to 10% 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 25% to 30% for Retail Media. For Commerce Audiences, we expect Contribution ex-TAC growth of approximately 30% as advertisers continue to shift more budgets and adopt full-funnel activation.

We now anticipate an Adjusted EBITDA margin of approximately 27% to 28% for 2023. This reflects the flow-through of our refined top-line and a 50 basis points impact from incremental FX headwinds due to the weakening of the Euro and Yen against the U.S. dollar.

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 was incurred in the first half of the year. For modelling purposes, we assume a flat number of shares outstanding in 2023.

Lastly, we are making great progress towards our long-term ambitions and our strategic plans to establish ourselves as the AdTech partner of choice for Commerce Media.

Along this journey, our commitment to our investors is to continue to be transparent. I would like to take a few minutes to provide an update on the financial aspects of our long-term growth ambitions that we shared with you this time last year at our investor day. The assumptions that underpinned our financial ambitions at that time, anticipated some, but not all of the dynamics that have affected the market over the past twelve months.

Starting with the macro-economic environment, as you already know, during late 2022, we, along with many in our industry, were impacted by a significant slowdown in advertising demand. Although the macro backdrop looks more stable today, it is still highly volatile, and this impacts our run-rate for growth.

Next, as you know, Google is entering the final stages of their Privacy Sandbox initiative. While Criteo has leaned into a close collaboration with Google and we remain confident about our own readiness, there are uncertainties related to Google's plan to test with live traffic and deprecate third-party cookies in the same year.

Thirdly, as a market leading tech provider in Retail Media, we are enabling long-term sustainable and profitable business models with our partners. For our most mature partners, our economic pricing model is evolving to drive further scale, higher lifetime value and more profitability. In this context, our largest retailer is expected to shift to a multi-year SaaS-like revenue fee structure for the services we provide. This self-service model enables increased efficiency, and opens up strong visibility into future revenue – and importantly, it drives further spend to our platform. In addition to recurring SAAS-like fees, our economic pricing model also includes take-rate volume-based fees and additional fees for value-added services. As a result of these changes, while we expect our Retail Media gross media spend to continue to outpace the market, we currently anticipate that our 2024 Retail Media Contribution ex-TAC growth rate could be lower than in 2023. We also continue to win new clients at a rapid pace including two of the U.S. largest retailers in recent weeks, and we are confident that Criteo is well positioned for sustainable growth and increased profitability.

Given these three factors, our ambition to achieve $1.4 billion in Contribution ex-TAC is not expected to materialize within the 2025 timeframe.

Our strategy remains the same. Our execution is tight. We are laser focused on top-line scale and profitable growth across our entire business, with operational cost efficiencies and margin expansion over time and solid cash generation. We're in the largest growth area of the market, and our focus on winning share in Commerce Media is relentless. Our strategy and execution is already paying off.

As we continue to execute and gain scale, we will report on our progress in realizing our ambition to be the partner of choice for Commerce Media, today and for the long term.

The future is wide open.

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

[…Q&A…]

Melanie Dambre – Vice President, 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.