November 4, 2015

Criteo Q3 2015 Earnings Conference Call – Prepared Remarks

Edouard Lassalle, Head of IR

Good morning and good afternoon to all of you, and welcome to Criteo's conference call on our financial results for the third quarter ended September 30, 2015.

The speakers on our call today are JB Rudelle, co-founder and CEO, and Benoit Fouilland, Chief Financial Officer. After our prepared remarks, Eric Eichmann, President & Chief Operating Officer, will participate in the Q&A session.

Please note that the earnings release issued before the opening of the US market today, along with a live webcast of our call are both available on our Investor Relations website at ir.criteo.com. A replay of the webcast will also be available later today on our Investor Relations website.

As usual, before we begin discussing our earnings, I would like to remind you that some of our discussions today will contain 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, these statements are subject to risk, 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. In addition, reported results should not be considered as an indication of future performance.

Also, I would like to remind you that we will discuss non-IFRS measures of our performance during the course of this call. Definitions of these metrics, and the reconciliations to the most directly comparable IFRS financial measures, are provided in the earnings press release and accompanying financial tables 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 am now turning the call over to JB Rudelle, Criteo's co-founder and CEO. JB, please go ahead!

<u>JB Rudelle, Co-founder & CEO</u>

Thank you Edouard. Good morning everyone. I am once again very pleased to report **a good quarter of profitable growth**. This marks the eighth consecutive quarter of exceeding our guidance for both Revenue ex-TAC and Adjusted EBITDA.

In the third quarter 2015, our Revenue ex-TAC increased 47% at constant currency to 120M€. And our adjusted EBITDA grew 55% at constant currency to 31M€. It's also worth mentioning that for the first time in Criteo's history, our gross Revenue crossed the €1 billion landmark on a last 12-month basis. We believe this symbolic threshold illustrates how much our clients are engaged with our solution.

At Criteo, we believe that when it comes to digital advertising, **technology-driven performance is by far the most important success factor**. The best way to measure this performance is by looking at the sales we generate for our clients. In the 12 months ended September 30, the post-click sales we generated for our clients increased 79% while our own Revenue grew 64%. We believe our continued momentum is the direct result of this strong focus, not only on general ad technology, but on technology specifically designed to maximize sales for our clients.

Over all those years, our vision has not changed. We are glad to see that it generates very tangible results quarter after quarter. And there is no better incentive for our clients to increase their usage of our platform than our total dedication to performance. This translates into this pretty interesting statistic: clients that were live in both Q3 of last year and Q3 this year generated **over 21% more Revenue ex-TAC at constant currency**.

Well-known by our long term investors, another key indicator of Criteo's unique model is our ability to generate, quarter after quarter, over 75% of our business from always-on uncapped budgets. This outstanding level of recurring business is extremely rare in our industry, which is typically plagued by high client churn due to poor Return On Ad Spend offered by most other players.

In this last quarter, our performance was driven by three main factors:

- First, as usual, we kept **enhancing our technology across all our client base**.
- Second, Q3 was **another strong quarter of new clients additions** across all regions.
- Third, **our direct publisher relationships have nicely expanded, too**.

Starting with the first driver, **technology**. As you know, over the last few years we've seen a massive **transition from desktop to mobile**. This transition is now pretty much complete, as

90% of our clients were using our multi-screen solution in September. We are excited about this multi-screen world, as we believe it gives us further opportunities to outperform competition. Thanks to a number of break-through mobile-specific technologies we have developed, our win rates on mobile are often twice as high as on desktop or even higher. Not only does this give us a meaningful competitive advantage, but it also helps our clients fully benefit from the **strong momentum in mobile commerce**. As a matter of fact, in Q3, mobile represented 35% of our clients' ecommerce transactions and represented an even greater share of our own business.

We are now going through another big trend: **the shift from using just one device to a world where every consumer routinely uses multiple devices to complete their e-commerce transactions**. Today 40% of transactions involve multiple devices prior to purchase. Our latest "State of Mobile Commerce" report revealed that mobile is becoming **THE** preferred purchase device for cross-device shoppers. More specifically, cross-device shoppers are 20% more likely to complete the transaction on their mobile device than the average user.

To take advantage of this massive trend, we are particularly excited about our **"Universal Match" cross-device solution**, which combines all devices into a single user experience for marketers. I'm very pleased to see that **over 2/3 of our clients** are now sharing anonymized CRM data with us. Our quickly expanding footprint enables the exact match of more and more users across devices. We clearly believe that cross-device shopping is the future and we will continue to invest accordingly to further expand our "Universal Match" solution to make it hopefully the "gold standard" of our industry.

Another important product is our **in-app offering**. While still relatively limited, our in-app Revenue ex-TAC grew 80% quarter over quarter. As you know, users are spending more and more of their mobile time within apps. While most of this time is still spent on games and social activities, we are seeing an increasing appetite for e-commerce activities. Amongst our clients, those who have already made their app experience a priority are now generating over 50% of all their mobile sales from apps.

In parallel, we continue to invest in our core technology across the board. As we indicated last quarter, our **new creative platform** allows us to optimize each individual creative component in our ads – from the font, color or the size of the picture to the call to action or price discount – resulting in an almost infinite number of personalized combinations. Our enhanced **Dynamic**

Creative Optimization platform was rolled out to many more clients in Q3. And in September, we generated close to 40% of our Revenue ex-TAC from clients using the enhanced platform.

Moving now to our second growth driver, **new client additions**. In Q3, we added **over 720 net new clients** while maintaining our client retention rate north of 90%. We ended the quarter with close to 9,300 clients, growing 41% year-over-year. While we added large clients in all markets, our continuous investments in midmarket translated into 100%+ growth on a Revenue ex-TAC basis. We believe our midmarket penetration of the global addressable market is still in the single digits only. In addition, there are still a lot of sizable midmarket advertisers that remain to be signed. A way to confirm this, is that our average Revenue ex-TAC per live midmarket client continues to grow +40% year-over-year in Q3 and +8% sequentially.

The third growth driver was the **further development of our direct publisher relationships**. In Q3, we added a record of almost 1,000 publishers and reached 11,800 direct relationships.

At the end of Q3, already more than 1,500 of our advertisers were live on **Facebook mobile** via our integration with Dynamic Product Ads aka DPA. We believe our “Universal Match” cross-device solution nicely complements Facebook’s cross-device graph on its own inventory.

To close on the supply side, I would also like to provide an update on **ad blocking**. As discussed previously, we don’t see consumers being massively against digital advertising overall. However, as expected, we are seeing a clear trend towards so called acceptable ad formats and we are glad to see the industry starting to recognize this. Moreover, we believe that ad blocking could paradoxically create new exciting growth opportunities for players who have the right tech stack and expertise. As an analogy, our innovative technical solution for Safari users has interestingly turned the complexity around mobile-privacy into a sustainable competitive advantage for us.

Moving now to our **performance by region.** We are once again very pleased with our execution across all geos.

In the **Americas**, our Revenue ex-TAC grew 67% at constant currency. Our business with new large clients accelerated by over 60% compared with the prior quarter. Furthermore, we grew our U.S. midmarket business by over 150%.

In **EMEA**, our Revenue ex-TAC grew 33% at constant currency, consistent with prior quarters. It's interesting to stress that **all** our large Western European markets continued to grow at robust double-digit rates.

In **Asia-Pacific**, Revenue ex-TAC grew 53% at constant currency and 14% sequentially. South-East Asia in particular continued to expand quickly, with exciting progress in the promising Indonesian market; potentially a very big one. In China, our export business on behalf of Chinese clients continued to see good momentum. We are pleased to confirm that, as planned, our Shanghai data center will be fully operational before the end of the year, paving the way to start scaling our domestic Chinese business in 2016.

Looking ahead, we remain **focused on our 2 key product priorities**:

1. Continue to invest in **mobile** with a strong focus on everything that increases sales. This includes apps, native ads and our "Universal Match" cross-device solution;
2. Continue to **expand into additional strategic marketing channels**. In particular, search marketing is one of our major long-term growth projects for 2016 and onwards. We are putting significant efforts into this field with a dedicated 50-strong team working exclusively on this new opportunity.

Looking forward, we are highly committed to our vision of becoming the **preferred partner for our clients when it comes to performance marketing**.

In closing, we believe our Q3 performance continues to demonstrate that

- quarter after quarter, we execute **in line with our growth plans**; and
- our investments are **paying off,** confirming the solidity of our vision.

We clearly look forward to updating you next quarter on our achievements and growth plans for 2016.

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

Benoit Fouilland, Chief Financial Officer

Thank you JB and good morning everyone. I'm also very happy to report another good quarter today. As usual, I will walk you through our quarterly financial performance in detail as well as our guidance for the fourth quarter and fiscal 2015. I will then open up the call to your questions.

In the third quarter, we continued to deliver **strong profitable growth**, exceeding our Revenue ex-TAC and Adjusted EBITDA expectations.

Our **Revenue** increased 54%, or 46% at constant currency, to 299M€, growing 10% sequentially.

As you know, **Revenue ex-TAC** is the key metric we use to monitor our business performance. Revenue ex-TAC grew 55%, or 47% at constant currency, to 120M€, compared with 78M€ in Q3 last year. Our Revenue ex-TAC margin was 40.2%, consistent with prior quarters.

Looking at our Revenue ex-TAC performance **by region** in the third quarter:

- The Americas region continued to grow rapidly at 88%, or 67% at constant currency, to 43M€.
- EMEA grew 34%, or 33% at constant currency, to 52M€.
- Asia-Pacific grew 59%, or 53% at constant currency, to 25M€.

Compared to guidance, changes in **foreign exchange rates** had a negative impact on our reported Revenue ex-TAC in Q3, driven by the high volatility intra-quarter, in particular for Emerging markets currencies like the Brazilian real. When compared with our Q3 guidance rates, changes in forex generated a 1.6M€ headwind, meaning our Q3 Revenue ex-TAC would have been 122M€ using the forex rate assumptions upon which our guidance was based. Compared to Q3 2014 however, forex continued to represent a tailwind, although to a lesser extent than in prior quarters, and bolstered our reported Revenue ex-TAC growth by 8 percentage points in Q3.

Moving now to our **profitability**, Adjusted EBITDA grew 58%, or 55% at constant currency, to 31M€. Adjusted EBITDA margin as a percentage of revenue was 10.5%, compared with 10.2% in Q3 2014. Our growth in Adjusted EBITDA was driven by our Revenue ex-TAC performance in the quarter, as well as lower than anticipated spending on certain items. In particular, we incurred approximately 2M€ of savings, primarily due to the successful outcome of the negotiated exit from our NYC office lease and lower than anticipated employee relocation expenses. In addition, approximately 3M€ of previously planned expenses did not materialize in Q3 and will instead be incurred in Q4. These relate primarily to internal IT and hiring expenses.

Moving to our **other costs of revenue**, hosting and data costs grew 66% to 15M€. Excluding capex amortization, other costs of revenue grew 53% to 8M€, driven by continued investments in server and hosting equipment, including our brand new Hadoop cluster.

Our **operating expenses** increased 50% to 88M€, as we continued to scale the organization to support our growth, in particular with respect to R&D and sales. On a "Non-IFRS basis", operating expenses grew 54% to 81M€.

Consistent with prior quarters, **headcount-related expenses** represented 75% of our total operating expenses. We ended the third quarter with 1,750 employees, representing a 48% increase compared with Q3 last year. We have added 449 net new employees in the first 9 months and are overall in line with our 2015 hiring plan.

Looking at operating expenses by function, non-IFRS **R&D** expenses grew 69% to 17M€. This was largely driven by a 56% increase in R&D headcount to 360 employees at the end of September. In Q4, we intend to continue to invest in R&D.

Moving on to **sales and operations**, non-IFRS operating expenses increased 52% to 48M€. This was also largely driven by a 44% increase in headcount to 1,085 employees at the end of Q3, in particular in our midmarket organization. As a percentage of revenue, non-IFRS Sales & Operations expenses decreased 0.3 percentage point year-over-year and 2.6 percentage points sequentially. Out of the 2M€ savings I mentioned earlier, approximately 1M€ was generated in Sales & Operations. In addition, Sales & Operations accounted for approximately 2M€ of the 3M€ opex initially anticipated for Q3 which we will now incur in Q4. We plan to continue to scale our sales and operations teams in Q4, in particular in our midmarket hubs in Boston and Barcelona.

In **G&A**, non-IFRS operating expenses increased 48% to 16M€. Our headcount grew 54% to 304 at the end of September, driven primarily by internal IT and HR teams. As a percentage of revenue, non-IFRS G&A expenses decreased by 0.2 percentage point year-over-year and 0.7 percentage point sequentially. G&A will account for the remaining 1M€ of opex that was planned for Q3 and will now be incurred in Q4. We intend to continue to scale our G&A functions in Q4.

Before we move to our cash generation, I'd like to say a quick word about our **financial income**. In Q3, we incurred a 6M€ financial loss compared with 6M€ of financial income in Q3 last year – the result of a 6.3M€ non-cash foreign exchange loss on intragroup positions, primarily with our Brazilian subsidiary. The exceptionally strong volatility in the Brazilian real and its 30% fall against the euro in Q3 negatively impacted our financial income despite our standard hedging program.

Net income for the quarter was 5M€, primarily as a result of negative financial income and an exceptionally high effective tax rate in the quarter. Adjusted net income in Q3 was 11M€, leading to an Adjusted EPS of 0.16€ on a diluted basis. In Q4, we expect changes in forex to continue to impact negatively our financial income, leading to a slightly higher loss for the full year than in the nine months to September. In Q4, we expect to recognize deferred tax assets in the US, leading to an anticipated effective tax rate between 20% and 25% for the full year 2015.

Moving now to cash generation, our **cash flow from operating activities** increased 43% over Q2 to 16M€, but decreased 38% compared with Q3 2014. This was primarily driven by an unfavorable change in working capital, particularly impacted by an increase in other receivables, including VAT, prepayments in relation to new facilities and implementation fees related to a 250M€ Revolving Credit Facility. Separately, our income taxes paid increased significantly compared with Q3 last year. For the first nine months of 2015, cash flow from operating activities grew 32% to 63M€.

Our **capex** for Q3 increased 93% to 22M€, growing 30% sequentially. This was largely driven by hosting capex for our new Hadoop cluster and our Chinese data center, as well as facilities capex for our new offices in London and New York. As a percentage of Revenue, capex was 7.2% in Q3 and 6% for the first nine months of 2015, in line with our previously disclosed expectations for the full year. As JB said, we expect our Shanghai data center to be up and running by mid-November. In Q4, we plan to continue to build and maintain additional hosting capacity in all regions.

Our **Free Cash Flow** in Q3 was flat compared to Q2. Similar to last quarter, this was primarily the result of unfavorable working capital impacts on our operating cash flow as well as the significant increase in capex, in line with our plans. For the first nine months of 2015, free cash flow stands at 14M€. The conversion of Adjusted EBITDA into Free Cash Flow for the last 12 months to September remains high at 38% and continues to reflect our scalable financial model.

Finally, **total cash** and cash equivalents were at 281M€ at the end of September, a 9M€ decrease compared with December 31, 2014. This was primarily driven by Free Cash Flow generation and proceeds from capital increases over the 9-month period, which were more than offset by the cash consideration paid for DataPop, the change in other non-current financial assets and a repayment of borrowings. Here again, foreign exchange had a negative impact, as 50% of the decrease in our cash position over the 9-month period related to changes in forex rates.

I will now wrap up with our **guidance**. I'll remind you that the following forward-looking statements reflect our expectations as of today, November 4, 2015.

For the fourth quarter 2015, Revenue ex-TAC is expected to be between **134M€ and 139M€**.

We expect Adjusted EBITDA for the fourth quarter 2015 to be between **39M€ and 46M€**.

Despite a 4M€ forex headwind as compared to assumptions made at the time of our prior guidance provided on August 4, we reiterate our Revenue ex-TAC outlook for fiscal 2015, which we expect to be between **470M€ and 475M€**. At the mid-point of the range, this would imply a 56% reported growth compared with 2014, or 47% at constant currency. Excluding the forex headwind, management would have expected to raise Revenue ex-TAC guidance by 4M€ for the full year.

Despite a 2M€ forex headwind as compared to assumptions made at the time of our prior guidance provided on August 4, we reiterate our Adjusted EBITDA outlook for fiscal 2015, which we expect to be between **120M€ and 127M€**. Excluding this headwind, management would have expected to raise Adjusted EBITDA guidance by 2M€ for the full year.

Our guidance assumes the following exchange rates: a euro-U.S. dollar rate of 1.11 for both Q4 and fiscal 2015, a euro-Japanese yen rate of 135 for both Q4 and fiscal 2015, a euro-British pound rate of 0.73 for both Q4 and fiscal 2015, and a euro-Brazilian real rate of 4.37 for Q4 and 3.71 for fiscal 2015. This guidance assumes no additional acquisitions are completed during Q4 2015.

Overall, we expect the fourth quarter to be another exciting quarter for Criteo and we are confident we will deliver strong results for the full year.

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