Q4 2019 Earnings Call | Prepared Remarks | February 11, 2020

Edouard Lassalle – VP, Market Relations

Good morning everyone and welcome to Criteo's Q4 and fiscal year 2019 earnings call.

With us today are CEO Megan Clarken and CFO Benoit Fouilland.

During the 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. Such 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 discussed today, except as required by law. In addition, reported results should not be considered as an indication of future performance. More information about our risks and other factors that could affect our results is regularly filed with the SEC and is available on our IR website.

Today, we'll also discuss non-GAAP measures of our performance. Definitions of such metrics and the reconciliations to the most directly comparable GAAP financial measures were provided in the earnings release published on our website earlier today.

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

With that, it's my pleasure to now introduce and hand it over to Megan.

<u>Megan Clarken</u> – CEO

Thank you, Edouard, and good morning everyone. It's a pleasure to be with all of you. On our call today, I'll cover **five** key topics.

- First, **what I've learned** during my first days at Criteo.
- Second, the **challenges** that we face as a company.
- Third, the **plans** and **new strategic priorities** the team are executing on to address our challenges and make the most of our opportunities.
- Fourth, the **highlights of our Q4 performance**.
- And lastly, our **outlook for 2020**.

Before I get to this, I'd like to **briefly introduce myself**. As some of you may know, before starting at Criteo, I led a major transformation at Nielsen which shifted the company from a legacy TV/Audio measurement company to a major measurement provider of digital and cross-platform ratings – and I'm really proud of this work. Way prior to this, I started my career as a track and field athlete at the young age of 10 and progressed to an elite status. Not the reason I'm telling you this is that my experiences make me what I am today. You'll find me a person of conviction, of grit and focus, not afraid of challenges and determined to beat them. I get things done. I'm empathic to your experiences with us and I want nothing but to be honest, transparent and to deliver results.

So what attracted me to join Criteo was the high-quality assets, including the global scale, continuous innovation and extremely talented and passionate people, and I'm deeply honored to lead the company into the next chapter of its development at such a pivotal point. During my first 80 days, I've listened to and learned a lot from our employees and customers. I immersed myself into our products and technology, into our value proposition and into how we meet the market's needs. Through all of these conversations, I've been struck by how essential our solutions are to our customers in building their marketing programs and driving return on their investments. That's a great starting point.

I also acknowledge that we're facing **challenges** that we need to address, and that you're all looking for responses from us. These are:

- Number 1, the **increased identity challenges**, including Google's latest announcement on Chrome.

- And number 2, the **decline of our retargeting business**, which hasn't yet been offset by the growth of our new solutions.

These are real and meaningful challenges that we must face as a company, but they're not insurmountable. In fact, I see them as **opportunities to differentiate from others** and to emerge **stronger**. I am confident that we're up for the challenge and that we have what it takes to succeed. So – let me address them both, starting with our **position on identity**.

We believe the industry is long overdue in replacing cookies as the technique used to personalize ad targeting on the web, and we welcome concerted industry efforts to evolve **beyond** cookies in privacy-safe ways. We're very well positioned for this shift. We have strong capabilities that put us **ahead** of the identity changes. All our solutions are developed in ***privacy-by-design*** ways and operate strictly under the consent of the user. We're proud of this. With strong convictions, we believe that users should also have a clear **individual choice** with regards to their ad experience, that personalized advertising brings multiple benefits to the ecosystem, including **at the user level**, and that browsers should **not control** data portability.

Today, we already have solutions, through our direct publisher integrations, our mobile ID-based solutions and Retail Media, that operate using **multiple first-party or cookie-less mechanisms**. They represent **close to 50% of our business**. We recognize that for investors, the broader identity topic may look like a major threat for us but, **to be clear, <u>we do not see things this way</u>**.

Our identity resolution strategy, leveraging our **differentiated** assets and providing for **four complementary layers**, will help us cover the **remaining 50%**:

- Firstly, **our first-party footprint.** As a trusted partner, we are integrated into **all** of our advertisers' and direct publishers' websites and we have a privileged position to embed ourselves into their workflow. This unique relationship means that large amounts of our data are first party which provides us the means to create an identity solution with our clients. This is a critical differentiation point for us.
- Second, we have an **unrivaled ID Graph.** 95% of our 2 billion+ IDs in the graph already contain a significant number of non-cookie identifiers. We can make our graph even more flexible by adding more persistent identifiers and new identification capabilities through trusted partners. This makes our ID Graph even less cookie-dependent over time and, added to the first point, a massive source of identity data.

- Third, we'll intend to **execute our product strategy** of moving higher up in the marketing funnel and shifting even more to mobile apps, video and connected TV, thus reducing our cookie exposure.
- And finally, we'll **use our voice to help shape the direction of the industry**. As the largest independent ad tech company, accustomed to adapting our practices to privacy regulations and technology changes, we believe we're in a strong position to partner with other players, trade associations, standard-setting groups and regulators to help define new industry standards for privacy-safe personalized advertising.

So, let me now switch to the **second challenge**, the decline of our retargeting business which has not yet been offset by the growth of our new solutions. We realize that turning our business around is going to be tough and that it won't happen overnight. This requires a focused transformation. We're in the process of formulating that plan. It requires that we leverage all of our assets. The plan is being built on **four strategic pillars** that will provide focus, organize our teams and drive momentum. These are:

1. To strengthen our retargeting business
2. To expand our product portfolio
3. To explore strategic game changers
4. And, to drive technology and operations excellence

One by one.

To strengthen the base business, we'll accelerate our initiatives to build out a differentiated full-stack DSP, adding capabilities for upper-funnel marketing on top of our strengths in lower funnel, and offering more flexibility and transparency throughout the stack. We'll do a better job of showcasing our unique global presence to brands and agencies. We'll focus on our goal – to create the marketplace for publishers and advertisers outside of the Walled Gardens, bringing quality and most importantly – choice. And we'll look into adjusting our value proposition, in particular for large customers.

To expand our product portfolio, we'll leverage our strong assets to capture a number of compelling new business opportunities. You've seen some evidence of this already. Retail Media continues to perform well, growing in the 20s throughout 2019, and showing great stickiness with retailers. We are the Retail Media solution of choice for many of the world's top retailers. For example, we recently renewed our longstanding partnership with Best Buy to deliver their sponsored products experiences. And we're excited about this. And, we'll intend to further broaden our consumer reach around app, video, Connected TV and Omnichannel. We're excited with the performance of our Omnichannel business which extends our consumer reach to offline. Omnichannel is one of the fastest-growing whitespaces for us. In 2019, our Omnichannel business grew close to 300%.

Moving to the 3rd strategic priority – **exploring game-changers**. We'll explore new propositions, in line with our strategy, through a mix of organic developments, partnerships and M&A. In particular, we'll look to build partnerships with ecosystem players to complement our capabilities. These will be in areas like cross-platform targeting, measurement, components required for our tech stack and more.

And finally, we'll continue to **drive technology and operations excellence**. We'll invest in tech innovation, while maintaining strong **profitability**. We have a strong, profitable and cash-generative financial model which, on top of our strong focus on driving further operational efficiencies, allows us to invest with flexibility in our strategic priorities and new opportunities.

Let's now **look back at Q4**. We had a solid quarter and exceeded the top end of our guidance for both Revenue ex-TAC and Adjusted EBITDA. While Benoit will provide more details later, some of the Q4 highlights included:

- Another **great performance during the holiday season**, demonstrating the critical value of our retargeting solution to retailers during this important time of the year;
- The **continued growth of our new solutions** now at 16% of our total business in Q4, driven in particular by our Consideration product and Retail Media;
- The **addition of 280 net new clients**, accelerating 16% from Q3 and 34% from Q4 in the prior year;
- And, continued discipline in expense management driving our **41% Adj. EBITDA margin**.

Lastly, our **outlook for 2020**.

2020 will be an important year. We have a lot of work to do and results will take time. I'll make sure that, in 2020, we lay the foundations for our long-term success and focus on the initiatives that drive the most impact in the long run.

A key objective for the long term is to capture opportunities that strengthen our revenue mix and make our business **more resilient and sustainable** over time. Within this long-term context, we took a **realistic** view on the 2020 business and factored in some **realistic** headwind assumptions. As a result, I expect our Revenue ex-TAC to decline by approximately 10% at constant currency in 2020. And, we'll ensure to **maintain strong profitability and cash flows** this year to support our long-term development.

When I next communicate in about 90 days, I intend to provide more details to help you monitor our progress towards our priorities. I am a firm believer in transparent communication and open dialog with all stakeholders. I strongly believe in delivering on our commitments and doing what we say we'll do. I'll therefore strive to be as open as possible in discussions with all of you and provide regular updates on our progress towards our strategic, operational and financial goals.

With that, I'll now hand it over to Benoit to discuss our Q4 results and our guidance. Benoit?

Benoit Fouilland – CFO

Thank you Megan, and good morning everyone. As usual, I'll walk you through our performance for Q4 and 2019, and share our guidance for both Q1 and fiscal year 2020.

Revenue was $653 million in Q4 and $2.26 billion for 2019. **Revenue ex-TAC**, our key metric to monitor the business, declined 1% at constant currency to $266 million in Q4, and grew 0.3% at constant currency in 2019, a touch above our guidance, to $947 million. Our Q4 performance, better than expected, was driven by a growing business with new clients in the midmarket, offset by a slight decline in our existing client business, despite a strong holiday season across regions and continued adoption of our new solutions among clients.

Currency changes in Q4 cost us over $2 million vs. prior year and provided a tailwind of about $1 million compared to our guidance assumptions. This translated into a $4 million overachievement above the high-end of our Revenue ex-TAC guidance for Q4.

Q4 Revenue ex-TAC margin improved 20 basis points to 41%, in line with our expectations.

Looking at **some of our operating highlights for Q4**:

- Our business **grew 7% globally** during the so-called **Cyber 6 days around Black Friday**.
- Our **new solutions** grew 44% to 16% of our total business, including our Consideration solutions growing more than 5x on Web and in the 50's on App. Retail Media grew in the low 20's with continued strong triple-digit growth of our transactional-SaaS model. On a full-year basis, this means our new solutions altogether grew 54% to 12% of the business.
- Our **retargeting product** continued to decline slightly – in the upper-mid single digit range – in particular with large customers.
- While impacted by the retargeting softness, our **same-client Revenue ex-TAC** declined 3% at constant currency but improved slightly compared to the -4% in Q3.
- We **added 280 net new clients**, ending the quarter with more than 20,200 clients globally, a 4% increase year-over-year, while **maintaining high retention** at 90% for all solutions.
- And, from a **supply** standpoint, more than 4,500 direct publishers are now connected to one of our Criteo Direct Bidders on Web and App, including RetailMeNot, SevenOne Media and eBay Kleinanzeigen in Germany.

Turning to our **Q4 regional performance**.

- Revenue ex-TAC in **the Americas** declined 3% at constant currency. While we had a solid holiday season as expected, good performance in Consideration and Retail Media, and continued traction in midmarket, our business with large customers remained soft. However, excluding the impact of a large customer loss in early 2019 and the anniversary of the Manage acquisition, Revenue ex-TAC in **the U.S. grew 1%** in Q4 and 2% in 2019.
- **EMEA** Revenue ex-TAC grew 1% at constant currency, in line with Q3 and our expectations. Once again, we had a strong Black Friday performance in many European markets. Midmarket continued to grow double-digit across the region and we saw marked improvement in our large customer business in particularly in Germany, France and the U.K.
- And **APAC** Revenue ex-TAC declined 2% at constant currency, also in line with Q3, driven by softness in our Japanese large client business, offsetting very strong performance in Korea and double-digit growth in midmarket across the region.

Shifting to **expenses. Other cost of revenue** decreased 19% in Q4, largely driven by a $10 million positive impact from the longer useful life of our servers, offset by the provision for the French digital tax. Non-GAAP other cost of revenue increased 2% in Q4. In 2019, other cost of revenue declined 11%, due to the lower depreciation and amortization on our hosting equipment throughout the year, but grew 13% on a Non-GAAP basis.

Operating expenses increased 3% in Q4 and were flat in 2019, driven by our strong focus on disciplined expense management and lower equity award compensation expense. In Q4, we incurred about $11 million of **restructuring costs**, largely related to the decision to close our R&D center in Palo Alto, including $6 million people-related and $9 million facilities-related costs, offset by $5 million forfeitures of equity award compensation expenses. On a Non-GAAP basis, which excludes restructuring, operating expenses decreased 7% in Q4 and 1% in 2019, in line with our plans. We expect our restructuring measures taken in 2019 to generate non-GAAP savings of **$21 million per annum** in 2020 and beyond.

Headcount-related expenses represented 66% of GAAP opex in Q4, down 6 points, and 72% in 2019. We ended 2019 with over 2,750 employees, flat year-over-year and down 1% sequentially.

Looking at non-GAAP expenses **by function**:

- **R&D** opex decreased 17% in Q4 to 11% of Revenue ex-TAC, driven by an increase in our Research Tax Credit and despite a 1% increase in headcount to 680 R&D and Product engineers. In 2019, non-GAAP R&D expenses decreased 6% to below 15% of Revenue ex-TAC, down 60 basis points. In 2020, we expect to continue to reduce non-GAAP R&D expenses as a percentage of Revenue ex-TAC, in large part due to closing our Palo Alto R&D center.
- **Sales & Operations** opex decreased 7% in Q4 to 29% of Revenue ex-TAC, despite flat headcount of 1,580 employees. Our quota-carrying sales and account strategists declined 3% year-over-year and 3% sequentially to about 710. In 2019, non-GAAP Sales & Operations expenses decreased 1% to 34% of Revenue ex-TAC. In 2020, we expect non-GAAP Sales & Operations expenses to slightly increase as a percentage of Revenue ex-TAC, despite further increasing automation and efficiency across all our platform and operations teams, as well as from right-sizing our offices worldwide.
- And **G&A** expenses increased 3% in Q4 to below 12% of Revenue ex-TAC, with flat headcount at 500 employees. In 2019, non-GAAP G&A expenses increased 5% to 12% of Revenue ex-TAC, up 80 basis points. This was driven by some internal team transfers as well as one-time consulting fees. In 2020, we expect non-GAAP G&A expenses to decrease as a percentage of Revenue ex-TAC, driven largely by efficiency gains and by our office right-sizing program.

Overall, we continue to focus on **effectively adapting our cost base** and will increase our focus on **productivity and efficiency gains** this year. As a result, we expect non-GAAP expenses across all functions to **meaningfully decline in dollar terms** in 2020.

On the **profitability** side, **Adjusted EBITDA** increased 6% at constant currency in Q4 to $109 million, or 4% above the high end of our guidance, translating into a 100% flow-through of the topline beat into Adjusted EBITDA. This drove our Adjusted EBITDA margin to slightly over 41% of Revenue ex-TAC in Q4, or about 300 basis points above the prior-year at constant currency. In 2019, Adjusted EBITDA declined 3% at constant currency to $299 million, but drove a margin of 32% of Revenue ex-TAC, **well above our 30% guidance** for the full year.

Depreciation and amortization expenses decreased 1% in Q4, largely driven by the change in the useful life of our servers and despite the accelerated amortization of Manage intangible assets for about $7 million. In 2019, our depreciation and amortization expenses declined 10%.

Equity awards compensation expense decreased 11% in Q4 and 27% in 2019, driven by the lower stock price over the period and restructuring-related equity forfeitures. In 2019, our SBC charge represented just over 5% of Revenue ex-TAC, down 180 basis points vs. 2018.

Financial expense declined 13% in Q4, largely due to lower losses on foreign exchange. For 2019, financial expense increased 13%.

And, our effective **tax rate** was 28% in Q4 and 29% for the full year, slightly below our 30% projected tax rate for 2019. I'm pleased that, as a result of adjusting our tax structure throughout the year, our provisions for income taxes decreased 13% and 14% in Q4 and 2019, respectively. We expect our projected tax rate to be about 30% in 2020.

Net income for Q4 decreased 2% to $41 million, driven by a 5% decrease in Income from Operations, offset by the lower financial and tax expenses. However, in 2019, net income was flat at $96 million. As a result, **Adjusted diluted EPS** increased 29% in Q4 to 1 dollar and 8 cents and 7% in 2019 to two dollars and 67 cents.

Cash flow from operations decreased 31% in Q4, driven by unfavorable changes in working capital and higher income taxes paid. In 2019, cash flow from operations declined 15%. In parallel, **capex** decreased 61% in Q4, due to meaningful capex savings and some timing effects, and declined 22% to $98 million in 2019, just above 4% of revenue, or 110 basis points below 2018. In 2020, due to significant savings in data center planning and management, we anticipate our capex program to represent just about 3% of revenue, a sizeable reduction from 5% in 2018 and 4% in 2019.

Free Cash Flow increased 4% in Q4 and declined 8% in 2019 to $125 million, to 42% of Adjusted EBITDA, in line with our 4-year historical average. However, excluding the cash impact of restructuring, Free Cash Flow of $132 million for 2019 was almost flat.

Finally, **cash** and cash equivalents increased $54 million throughout the year to $419 million.

With respect to the **$80 million share-buyback program** we launched last August, as of the end of 2019, we had purchased approximately 3.2 million shares for a total cash amount of $59 million, at an average price of $18.07 per share. We're currently still executing on the program and intend to continue until completion.

I will now provide our **guidance** for the first quarter and fiscal year 2020. The following forward-looking statements reflect our expectations as of today, February 11, 2020.

In Q1 2020, we expect Revenue ex-TAC **between $209 million and $212 million** on a reported basis. Three reasons make us cautious in Q1. First, we have a strong comparable basis in Q1, partly driven by the strong contribution of a particularly large U.S. client that was lost at the end of Q1 last year. Second, we're seeing a soft start and, after the strong holiday season, a more pronounced budget softness than usual this year. And third, our large customer business in the U.S. remains soft. As a result, we think we're going to see Revenue ex-TAC decline by 10% to 9% at constant currency in Q1. We expect year-over-year forex changes to be a headwind to reported growth of about $2 million or 100 basis points.

With regards to the full year 2020, we've taken a **realistic** view on the business and factored in some **realistic** assumptions around ad-targeting restrictions and stricter implementation of privacy regulation. We anticipate these headwinds to impact **over 7 points** of growth in 2020. As a result, we expect Revenue ex-TAC to **decline by approximately 10% at constant currency**. Using our forex assumptions, this means Revenue ex-TAC of approximately $848 million. Compared to 2019, we see forex changes having a negative impact of approximately $4 million or about 50 basis points of reported growth. We do not intend to go into the details of our headwind assumptions for the year.

On the profitability side, we expect Q1 2020 Adjusted EBITDA **between $55 million and $58 million**. And, for 2020, we expect Adjusted EBITDA margin of **approximately 30% of Revenue ex-TAC**, as we further increase our focus on productivity and efficiency, and continue to proactively adapt our cost base.

As usual, currency assumptions supporting our guidance for Q1 and fiscal 2020 are included in our earnings release.

In closing, I am pleased with our solid Q4 performance and **better close to 2019**. 2020 will be an **important year** for us. We strive to maintain strong profitability and cash flows to strengthen our business for the long term. While the team focuses on the initiatives driving the most impact on our long-term topline, our strong financial discipline, profitable model and large cash flexibility will help us capture compelling opportunities faster.

With that, we will now take your questions.

[…Q&A…]

Edouard Lassalle – VP, Market Relations

Thank you, Megan, Benoit. This now concludes our call for today. The IR team is available for any follow-up. We thank everyone for attending and wish you all a good end of day.