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CRTO - Q4 2019 Criteo SA Earnings Call

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PRESENTATION

Operator

Good morning, and welcome to Criteo's Fourth Quarter and Fiscal Year 2019 Earnings Call. (Operator Instructions) Please note, this event is being recorded.

I would now like to turn the conference over to Edouard Lassalle, VP of Head of Market Relations. Mr. Lassalle, please go ahead.

Edouard Lassalle - *Criteo S.A. - VP & Head of IR*

Thanks, Anita. 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 the 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 now to introduce and hand it over to Megan.

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Megan Clarken - *Criteo S.A. - CEO*

Well, thank you, Edouard, and good morning, everyone. It's a pleasure to be with you all. On our call today, I'll cover 5 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 the 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've started my career as a track and field athlete at the young age of 10 and progressed to an elite status. Now 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 next chapter of its development at such a pivotal point. And 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 one, the increased identity challenges, including Google's latest announcement on Chrome and number two, the decline of our retargeting business, which hasn't yet been offset by the growth of our new solutions. Now 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'm 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, and we're proud of this. With strong convictions, we believe that users should also have the clear individual choice with regards to their 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 that are direct -- 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 broad identity topic may look like a major threat to us, but to be clear, we do not see things this way. Our identity resolution strategy, leveraging our differentiated assets and providing for 4 complementary layers will help us cover the remaining 50%.

So firstly, our first-party footprint. Through the trusted partner, we're integrated into all of our advertiser and direct publisher 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 plus 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 the marketing funnel and shifting even more to mobile apps, video and connected TV, thus reducing our exposure. And finally, we use our voice to help shape the direction of the industry. As the largest independent ad tech company, accustomed to adapting our practices 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 realized that turning our business around is going to be tough, and then 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 4 strategic

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pillars that will provide focus, organize our teams and drive momentum. These are: number one, to strengthen our retargeting business; number two, to expand our product portfolio; number three, to explore strategic game changers; and number four, to drive technology and operations excellence. So 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 of 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 to many of the world's top retailers. For example, we recently renewed our long-standing partnership with Best Buy to deliver their sponsored product experiences and we're really 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 wide spaces for us. In 2019, our omnichannel business grew close to 300%.

Moving to the third 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 solutions 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% adjusted EBITDA margin.

Lastly, our outlook for 2020. 2020 will be an important year, and 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 a long-term success and focus on the initiatives that drive the most impact in the long run. 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. 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'm a firm believer in transparent communication and open dialogue with our 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.

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

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Benoit Fouilland - *Criteo S.A. - CFO*

Thank you, Megan, and good morning, everyone. I will walk you through our performance for Q4 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 mid-market, 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 versus 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 now 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 50s on app. Retail Media grew in the low 20s with continued strong triple-digit growth of our transactional SaaS model. On a full year basis, this means our new solution 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 minus 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, on 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 mid-market, our business with large customers remain soft. However, excluding the impact of a large customer loss in early 2019 and on 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 on our expectations. Once again, we have a strong Black Friday performance in many European markets. Mid-market continued to grow double-digit across the region, and we saw marked improvement in our large customer business, in particular, in Germany, France and in the U.K.

In 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 mid-markets 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 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 cost, 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 exclude 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.

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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 now 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 and operation 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 and operation expenses decreased 1% to 34% of revenue ex TAC. In 2020, we expect non-GAAP sales and operation expenses to [slightly increase as a percentage of revenue ex TAC despite] (corrected by company after the call) further increasing automation and delivering efficiencies across all of our platform and operation teams as well as from rightsizing 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 owned by our office rightsizing 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. This translates into a 100% flow-through of the top line 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 that 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 managed 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 stock-based compensation charge represented just over 5% of revenue ex TAC, down 180 basis points versus 2018.

Financial expense declined 13% in Q4, largely due to lower losses on foreign exchange. For 2019, financial expense increased 13%. And our FX 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 provision 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 to $96 million. As a result, adjusted diluted EPS increased 29% in Q4 to $1.08 and 7% in 2019 to $2.67.

Cash flow from operations decreased 31% in Q4, driven by unfavorable changes in working capital and higher income tax 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. It 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 sizable reduction from 5% in 2018 and 4% in 2019. Free cash flow increased 4% in Q4 and declined 8% in 2019 and 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.

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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 are currently still executing on this 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 expectation as of today, February 11, 2020. In Q1 2020, we expect revenue ex TAC between $209 million and $212 million on a reported basis. 3 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. clients that was lost at the end of Q1 last year; second, we are 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 that we are 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 regard to the full year 2020, we've taken a realistic view on the business and factored in some realistic assumptions around ad targeting restriction 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 assumption, 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 assumption 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 both Q1 and fiscal 2020 are included in our earnings release.

In closing, I'm 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 initiative, driving the most impact on our long-term top line, our strong financial discipline, profitable model and large cash flexibility will help us capture compelling opportunity faster.

With that, we'll now take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question today comes from Dan Salmon with BMO Capital Markets.

Daniel Salmon - *BMO Capital Markets Equity Research - Analyst*

Megan, I had a couple of high-level ones for you, as you might expect. Firstly, as you come into the ad tech sector here, there's a long time debate over whether or not these companies represent software companies or not. And I think it's fairly clear that you build software. The question is always around the revenue model. And that your prior company at Nielsen was one of the few companies in the ecosystem that created products that people were willing to pay for every day on a subscription basis. And so obviously, that was a very different business. But I'm just curious about what you feel you can bring with your experience in understanding that to Criteo? And what type of revenue models you can help boost here around transactional SaaS, for example? And do you think the revenue model for the core retargeting business needs to change? And then just a follow-up is, as I'm sure you know that the company obviously works largely directly with marketers traditionally. I'd just love to hear a little bit more about what you think the role of agencies or just maybe not so much the big guys that we always think of, but a broader reselling community and whether or not that's important to you as you step forth with Criteo.

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Megan Clarken - *Criteo S.A. - CEO*

Firstly, Dan, it's good to hear from you. Thanks for the questions. In terms of the ad tech environment and the pricing models, you're right. I come from a company that has both contracted pricing. So fixed rates, and also CPM pricing in many cases, on the digital side. Clients want transparency, and they want stability, and we want the same. So I think that there is an opportunity to review those things at Criteo and make sure that it isn't a black box. It is an environment where we can have both of those pricing models. Again, it will take time and it'll take research into how that works and if that works. But everything that we do should be based on transparency to the client, flexibility to the client, sustainable business models and a way to make sure that we have some predictability around revenue, and they have predictability around spend. So we're open to analyzing a number of different points there. In terms of marketers, I think the agencies are incredibly important. They have been for some time and maintain their position as being the broker between the buyer and the seller. And Criteo in the past has not focused very heavily on agencies. My intention is to change that. I think we should have a relationship with agencies. We should be developing solutions for agencies to make their jobs easier at the lower funnel. We should be providing data into agencies to inform them of what's going on. We should be shaping their strategies. And for all those reasons, I think getting close to the agencies is really important. I think the they need our help, and we're prepared to go in that direction. So it's an important part of the full funnel operation going forward and the extension of our business out beyond retailers into other verticals, including agencies. I hope that's helpful.

Operator

The next question comes from Matthew Thornton with SunTrust.

Unidentified Analyst

This is Anthony on for Matt. On the ID graph, what percentage of that is non cookie based? And of that, what percentage would you say is owned versus licensed from your partners? And then second, if we may. Are you seeing any early impact from the California Consumer Privacy Act?

Megan Clarken - *Criteo S.A. - CEO*

So let me start off with the ID graph. As I said before, 95% of it is not cookie based. And it is data that is ours. And that we use with the ecosystem that we service as a whole. So we have access to that clearly for targeting purposes. And more importantly, to service the entire upper funnel proposition and to move us further away from cookie exposure. The idea, of course, is to connect that with the first-party data and to bring in other potential partners as well that can increase the size of that ID graph. And one of the current partners, as you'll know, is LiveRamp, and we'll have all intention to bring in more. And that is a massive, massive source of non-cookie based data that we'll use to make sure that we stay away from being trapped into a cookie environment.

Benoit Fouilland - *Criteo S.A. - CFO*

So just maybe, this is Benoit, just to add precisely on the portion of the graph that doesn't rely solely on cookies is 95%. So 95% of the ID graph doesn't rely solely on cookies.

So maybe just on CCPA , I can take it. So maybe just on CCPA, what -- as you know, through the implementation on from 1st of January users need now to agree on the usage of their personal data by third-party partners. So what we've done is we've adapted our service to the needs of our clients, and we see 2 types of clients. Clients that are happy to implement opt out capabilities on their service and clients who do not want to go through the route of the opt out capabilities and for which we have modified our agreement with them to work as a pure service provider for them. So we are flexible in the way we adapt and what we see is a smooth transition through the client base at this point.

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Operator

The next question comes from Doug Anmuth with JPMorgan.

Douglas Till Anmuth - *JP Morgan Chase & Co, Research Division - MD*

First, I just wanted to ask about the first-party data, Megan, that you talked about. Just trying to understand better the trend that you're seeing on the first-party data, how your retention is with those partners in your ecosystem and how do you maintain that. And then just on the 7 points, Benoit, that you talked about through 2020. Is that more specifically related to the Google changes? Or is it a collection of other things in there as well?

Megan Clarken - *Criteo S.A. - CEO*

Yes, let me start with the first party, Doug, and thanks for the question. We have a privileged position with our clients, both from the publisher and the advertiser side, and bear in mind, the size of the advertising base is about 20,000. The size of the publisher base is about 4,500 and growing. And we have a privileged position that they need us, so we become part of their workflow. So they build us into the way in that they go about understanding their client base and the way in which they target. So we get data back directly from them. And clearly, that's data that's flowing through all the time. And I guess that's part of the solution. 100% of that first-party data is with our clients. So again, they want us to understand their clients. They pass that data through to us so that we can provide the service that they're looking for.

Benoit Fouilland - *Criteo S.A. - CFO*

Okay. Maybe just regarding the 7 points of headwinds that we've baked into our guidance. I mean, the reason why we took a realistic view is primarily to address 2 topics, the first one is the ad targeting restriction. And the second one is relating to regulation. So without getting into the full breakdown, with respect to ad targeting restriction, it is primarily through the implementation of further restrictions that have been announced effective this year in browser, so namely Firefox on the Microsoft.

And with respect to the regulation, we took a view that there would be a stricter GDPR implementation that could have a material impact to the business as up to the 7%.

Operator

Next question comes from Sarah Simon with Berenberg.

Sarah Simon - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Yes, most of my questions have been answered, but I just had a question on the margin. Because Benoit when you talked your way through your 2020 outlook for costs, non-GAAP costs as a percentage of revenue ex TAC, I think you said all 3 categories would be down. But your guide, which would imply a growing margin, but you're implying or you're guiding for a slight decline in the margin on a full year basis. So have I misheard one of these categories in terms of decline versus increase as a percentage of revenue ex TAC?

Benoit Fouilland - *Criteo S.A. - CFO*

Sarah, thank you. Thank you for the question. So no, in fact, if you combine our guide for the top line. Where we've guided to approximately 10% decline for the year, despite contracting our cost base, our cost base is expected to contract on all categories. But despite this contracting of the cost base, we are guiding for a slight decrease in margins, 30% margin in terms of GAAP compared to the margin of the year, whereas last year, we

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delivered 32% margin. So it's a combination of a decline on the top line and contraction on our cost base, which is a slightly lower rate than the decline on the top line. But of course, we will monitor very closely our cost base.

Sarah Simon - *Joh. Berenberg, Gossler & Co. KG, Research Division - Analyst*

Okay. So you're expecting some of these costs -- but you're expecting some of these costs, therefore, to grow as a percentage of revenue ex TAC?

Benoit Fouilland - *Criteo S.A. - CFO*

Yes. As a result of this, you are going to see some of these costs slightly increasing as a percentage of revenue ex TAC. And that would be primarily -- I think that would be primarily within the sales and operation. Because product on R&D is going to be benefiting from the rightsizing of the location now that we've closed the Palo Alto center, and we are going to deliver efficiency on the G&A side. So that will be primarily in sales and operations that you will not see -- you will see a small deleverage as a percentage of revenue ex TAC.

Operator

The next question comes from Andy Hargreaves with KeyBanc.

Andrew Rex Hargreaves - *KeyBanc Capital Markets Inc., Research Division - Senior Research Analyst*

Just wondering if you can give us sort of your perspective on the qualitative factors that are driving some hesitancy, I guess, around retargeting. There's obviously been platform issues, but it does seem like there's been sort of an attitude change. And I'm just wondering if you could talk through that a little bit? And then Benoit, I just wanted to ask 2 questions around through cash and balance sheet. One, do you have a number for what you expect the restructuring, the cash restructuring costs to be in 2020? And then can you just walk us through sort of priorities for the balance sheet? And any thoughts on sort of conserving cash until Google's plans are more clear.

Megan Clarken - *Criteo S.A. - CEO*

Andy, are you talking about the large clients, in particular, in terms of the retargeting thing?

Andrew Rex Hargreaves - *KeyBanc Capital Markets Inc., Research Division - Senior Research Analyst*

No. I guess I'm talking about the -- well I'm talking about there's been client losses, there's been declines not associated with platform changes. What is just the competition? Is it just hesitancy around the individual targeting for perception purposes? What's driving all that?

Megan Clarken - *Criteo S.A. - CEO*

We're not necessarily seeing that. Firstly, the mid-markets are growing well. We've got double-digit growth for our mid-market in Q4 and for the second half of 2019. We see softness in the logic clients. And the things that we're seeing is that they are moving their budgets around between upper funnel, mid funnel and lower funnel. And I guess, that's to be expected as they change tactics that try and make the most of the different opportunities across those funnels. And we tend to see trends in that. They're also after a full funnel solution and one that's unbundled and one that offers software-as-a-service. Because they want flexibility and transparency to be able to make the right choices as they move their ad spend between the different layers of the funnel. So there are ebbs and flows. Our priorities around this to build out that full stack, as I said before, to allow them to move their spend around between the funnels and use a single provider to do that with a single set of data to really focus in on showing them the power of the global footprint that we have so that they can measure and look for trends across the market to continue to grow out mid-market client base, to be more client centric, to be more flexible and to make sure that they're comfortable that the solutions that we use

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are privacy safe and are safe from the restrictions of third-party cookies. So that's what we see. We see larger clients experimenting across the funnel and across platforms.

Benoit Fouilland - *Criteo S.A. - CFO*

Okay. So with respect to restructuring in 2020, we've not given any indication on restructuring for 2020. Of course, we would dynamically manage our cost base as and if required during the course of the year, but we do not, as of now, have a guidance with respect to cash restructuring in 2020.

And I think, Andy, your last -- I think I've lost your last question with respect to, was it around the use of cash?

Andrew Rex Hargreaves - *KeyBanc Capital Markets Inc., Research Division - Senior Research Analyst*

The priorities for the cash and any thought on just conserving it given sort of ongoing uncertainty around Google.

Benoit Fouilland - *Criteo S.A. - CFO*

So I think with respect to capital allocation, as you know, we've always had a balance on quite prudent capital allocation. So in the context of the strategic agenda that we have to drive, we will most probably keep a large portion of the cash with respect to driving potential strategic game changers during the course of the year, which is part of our strategic pillars for the year.

Operator

The next question comes from Lloyd Walmsley with Deutsche Bank.

Lloyd Wharton Walmsley - *Deutsche Bank AG, Research Division - Research Analyst*

Maybe one for Benoit and one for Megan. Benoit, any impact in the U.S. from just the shorter holiday period between Thanksgiving and Christmas? And then Megan, just kind of big picture. You guys have a very long road ahead of you diversifying the revenue mix, public markets appear to be fairly skeptical. So I guess, why go through this as an independent public company and not look at strategic alternatives?

Benoit Fouilland - *Criteo S.A. - CFO*

Okay. So with respect to the peak season, as we've confirmed in our prepared remarks, we had a strong peak season in Q4 across both Europe and the U.S. And in the U.S., we've seen a good dynamic big season. So no particular impact of the calendar here. With respect to -- I think one of the points I would just add on the peak season is the strength of the peak season are most probably an impact with respect to the spending that we've seen in January because some of the larger retailers who have end of the year date in end of January have maxed out their spending in -- during the peak season, which had probably an impact on the slow start that we've seen in Q1.

Megan Clarken - *Criteo S.A. - CEO*

With regards to the question around the challenges of company in the public markets. The focus that I have is to just to get my head down and turn the business around. So that requires to redirect and to motivate the team is to put the plan in place, prioritize and then focus on execution and that's what I'm going to do. I'm not going to -- the Board has not asked me to go into anything other than that. It's just simply to turn the business around. And I truly believe that this can be done through the strategic plan that we put in place, the energy of the organization, the assets that we have and staying laser-focused on executing through 2020 and driving for results.

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Operator

Your next question comes from Nick Jones with Citi.

Nicholas Freeman Jones - *Citigroup Inc, Research Division - Assistant VP & Senior Associate*

Just one on M&A, how do you feel about the pipeline of potential acquisition targets to help bolster your technology? Any color there would be helpful.

Megan Clarken - *Criteo S.A. - CEO*

Yes. So let me call it, sort of partners and potential M&A. We have a lot to do, and we can either build things, buy things or partner for things. And so as we build out the requirements in order to achieve what we need to achieve, we identify the gaps. And in filling those gaps, again, we can build, buy or partner. We have a long list of opportunities in terms of partnerships. And there's obviously always a line of sight into potential M&A to be able to, again help us execute against the plan. But it is to fill the needs in order to build out and execute the strategy. We think there's a lot of opportunity there, but we'll move with caution, and we'll make sure that anything that we do is incremental to our business and is -- are the right choices in terms of executing against the plan.

Edouard Lassalle - *Criteo S.A. - VP & Head of IR*

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

Benoit Fouilland - *Criteo S.A. - CFO*

Thank you.

Megan Clarken - *Criteo S.A. - CEO*

Thank you.

Operator

This conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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