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CRTO - Q1 2020 Criteo SA Earnings Call

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PRESENTATION

Operator

Good morning. Welcome to Criteo's First Quarter 2020 Earnings Call. (Operator Instructions) Please note, this event is being recorded.

I would now like to turn the conference over to Edouard Lassalle, Vice President and Head of Investor and Analyst Relations. Please go ahead.

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

Thank you, Kate. Good morning, everyone, and welcome to Criteo's Q1 2020 Earnings Call. We hope you all safe and healthy wherever you are.

With us today are CEO Megan Clarken; and CFO, Benoit Fouilland. Please note that because the lockdown restrictions, we are all joining this call from different locations today and, as a result, may face some unwanted technical challenges.

In the course of our call, management will make certain forward-looking statements. These forward-looking statements reflect Criteo's judgment and analysis only as of today, and actual results may differ materially from current expectations based on a number of factors affecting Criteo's business. Importantly, at this time, the global COVID-19 pandemic is having a significant impact on the global economy, on the business of our clients as well as on Criteo's business and may further impact Criteo's financial condition, results of operations and cash flows. There are significant uncertainties about the duration and extent of the pandemic impact. The dynamic nature of these circumstances means that what is said on this call today could materially change at any time. For more information, please refer to the risk factors discussed in our earnings release as well as our most recent Form 10-K filed with the SEC. We do not undertake any obligation to update any forward-looking statements discussed today, except as required by law.

In addition during this call 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 are included 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.

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

Thank you, Edouard, and good morning, everybody. It's a pleasure to be with you all for our second call together. I'm joining you from the safety of my home in Upstate New York, and I hope everyone is staying safe as well.

On our call today, I'll cover 4 key topics: Firstly, how we're adapting to the circumstances of the COVID-19 outbreak; second, our current assumptions for the business of COVID-19 for the rest of 2020; third, our progress on our 4 strategic pillars which I outlined in our last call; fourth, the latest developments on our online identification plans, in particular, around Chrome; and fifth, our strategic and operational priorities for the rest of the year.

Let me start by saying that in my first full quarter as CEO, I've been confronted with a very different set of challenges from the ones that I expected when I joined. Still, we tackle the challenges as they come. I'm very proud of our team's agility, and I'd like to thank each and every Criteo for their outstanding contribution throughout the early stages of the crisis and to this day.

As I indicated during our last earnings call, I'm a firm believer in transparent communication and an open dialogue with all stakeholders. It's, therefore, my intention to be as clear and helpful as possible today and providing you with the visibility you need on our business during these unusually fluid and challenging times.

To my first point. We adapted early and quickly to the circumstances of the COVID outbreak. The safety of our employees has been our immediate and #1 priority. We closed all of our offices around the globe before local authorities' requirements. Our policy is safety first, always. At the same time, we focused on business continuity to ensure all of our operations and R&D functions remained 100% up and running, and our associates had all the resources they needed. We quickly put in place -- a plan in place for supporting our clients, securing our data centers and maintaining our internal processes. And I'm pleased to say that today, we're operating very smoothly, thanks to tight communications and seamless alignment within and across teams.

We're also supporting our clients more than ever during these times. For example, we're providing COVID-related weekly updates about shopping trends across categories and regions. We're assisting clients and trying to identify new revenue opportunities and helping them to adjust their messages in line with the new paradigm. And we're working with them to leverage the significant rise in online users to capture new audiences and build customer loyalty for their businesses.

We launched several social contribution campaigns to help all those on the front lines for assisting people around the world. For example, our technology enables the APHP Foundation in Paris to raise funds in order to improve the working conditions of medical teams and fund research on COVID-19 treatments. We're also running pro bono campaigns for the Ad Council, a nonprofit organization promoting the works of various nonprofit NGOs and U.S. government agencies. Internally, we also immediately applied financial rigor and took incremental measures to control our cost base. I'll talk to that in greater detail in a few minutes. We intend to continue to manage our business in this way during this time: People and safety, operations and clients, cost control and social responsibility. And this gets me to my second topic.

As early as April 1, we communicated our updated Q1 guidance to the market and exceeded our initial adjusted EBITDA target. Benoit will talk more about this in a few minutes, so for now let me talk about the potential implications of COVID-19 for Q2 and the rest of 2020.

Whilst acknowledging that there are still many moving pieces and we continue to learn more every day, I want to establish that our current forecasting framework is based on the best knowledge we have as of today, April 29. We started feeling the COVID-19 impact from mid-February on. Different verticals have been impacted differently. Traditionally, our business mix is about 70% Retail, 10% Travel, 10% Classified and the remaining 10% a collection of verticals, including auto, finance and gaming. Spend in the Travel vertical decreased by around 95% compared to pre-COVID-19 levels, while spend in Classifieds decreased by 40% or more.

Retail, by far, our biggest vertical, has held up well, with spend reductions in our core solutions limited to about 10%. The impact also varied by client segment as mid-market clients sustained their spend in more resilient ways than large clients. We saw a healthy 5% increase in our mid-market client base. We also saw different developments in our various geographies related to factors like the time of the outbreak, the restrictions on social life and the industry mix.

And finally, pure online clients have seen less impact than those with a more traditional brick-and-mortar model, challenged by the temporary closures of their stores. These indicators, along with the other factors -- along with other factors have helped shape our modeling for the remainder of the year.

Looking forward, in short, we see a slow recovery out of the crisis with no full return to pre-COVID levels by the end of the year. We've built various scenarios based on a framework with 2 critical dimensions. Number one, the timing of the trough by business vertical and geography. And number two, the pace of recovery by vertical and geography. Within these scenarios, we've benchmarked our assumptions against our own data, third-party data, and against what we learned from our clients about the short and mid-term effects on their businesses. I'll focus now on the projected assumptions that form our mid-case scenario.

On the first dimension, the timing of the trough, we assume that our Retail client spend has reached its low points in EMEA and APAC but will deepen further in the U.S. until end June. In Travel, we assume that it has already reached its low point and will plateau now until early July. For Classifieds, we model a further deepening in the U.S. and APAC, namely Japan and then a plateau until the end of June.

On the second dimension, the pace of recovery, we assume that Retail will gradually recover in EMEA over the second half of 2020 aided by government support measures but will remain weak in the U.S. into Q4. For Travel, we've modeled a much slower recovery leading to a still material impact by the end of the year. And for Classifieds, we see a gradual recovery over the second half.

I acknowledge these assumptions carry a lot of uncertainty. There are still many things we don't know today, and things are rapidly changing. As a result, we'll intend to update you as we progress throughout the year. Taking all of these considerations into account and as of today, we believe our business in Q2 will decline by 32% to 35% year-over-year on a revenue ex-TAC basis, and from this level, may see a progressive recovery during the second part of the year. This obviously assumes there isn't another significant wave of COVID-19 outbreak during or after the projected recovery or any unexpected material economic disruption of any kind.

In response to the consequences of COVID-19 on our business, we took immediate and meaningful incremental measures to further contain costs. We implemented a strict hiring freeze until further notice. We stopped business travel. We cut marketing spend, events and third-party services and further optimize hosting costs. These reductions came in addition to the savings already included in our 2020 guidance provided last February. We intend to further implement cost control measures to right size our business during this time while maintaining our investment in our product strategy.

Now let's take a look at how we deliver against our strategic pillars, which remain in focus. And firstly, our core business remains resilient and shows positive signs. Our retargeting business with large clients has been softer so far, especially in the Travel and Classifieds verticals, and a function of large clients temporarily reducing spend or pausing campaigns rather than stopping working with us. However, we see the Retail vertical holding up much better than other verticals as e-commerce grows due to the crisis. Our mid-market remains resilient in the current circumstances, particularly in Retail, and continued to grow in Q1, driven mostly by new clients.

Second, we continue to expand our product portfolio. We're excited by the growth and resilience of our new products. Our App Install has performed well since the outbreak, growing over 90% in Q1, especially with nontraditional clients. This was close to 45% better than expected. Our App Install solutions drive customer acquisition by having new users install our clients' mobile apps on their devices. As most global consumers are locked down within the confines of their homes and look for entertainment or information or simply want to communicate on their phones, we believe demand for App Install may remain high throughout the various innings of the crisis. Another positive is that apps are cookie-less by design and therefore immune to all cookie restrictions.

Retail media grows strongly across the board, accelerating to 41% in Q1, as brands benefit from increased consumer use of e-commerce for a broad range of product categories, such as webcams, shaving and grooming gear, lounge wear and exercise equipment. In Q1, we created a business partnership with Unilever, which adds tremendous value for Unilever brands from both the data, insights and resources perspective. We also expanded our business with Carrefour with a huge increase in traffic to their sites in reaction to the COVID outbreak, our teams enabled Carrefour to effectively address their brand advertisers' requests while preserving great customer experience.

At a time when e-commerce has become the new normal for consumers, retail media proves not only resilient but countercyclical, in particular, in the grocery space. For this reason, we believe we offer even higher strategic value to brands and retailers when an online presence becomes critical for brick-and-mortar retailers beyond Amazon. Looking forward, we expect demand for retail media to continue to flourish, and we're excited to launch our new unified retail media platform expected late in Q2. This platform will combine our various retail media offerings and provide retailer and brands with self-service transparency and control over their full-funnel ad campaigns using sponsored products and other rich ad formats.

Third, we made good progress with our strategic game changers. As I explained in our Q4 call, we're exploring what we call strategic game changers to accelerate the execution of our strategy. These aim at strengthening our core business and expanding our portfolio with new solutions, especially around best-in-class full-stack DSP. In Q1, we added new partners for audience creation and brand safety, such as LeadsBridge and Oracle Data Cloud. We expect these partnerships will strengthen our consideration solutions.

And I'm excited about our strategic relationship with Nielsen announced last week that will allow us to integrate with their digital ad ratings and digital brand effect measurement solutions. We believe offering independent measurement from a global leader like Nielsen will enable our clients to understand the brand lift benefits and their performance -- of their performance campaigns as well as measure the demographics of consumers they reach across platforms as we evolved into a full-funnel ad-tech platform and align our technology to a broader array of marketing objectives and insights, including CTV. This integration will provide more transparency, flexibility and performance for brand advertisers.

In April, we hired David Fox, our Chief Development Officer, joining from Stellar Labs whose focus will be on further strengthening our offering through more strategic partnerships. I want to emphasize that in executing our strategy, we prioritize the use of our cash primarily for building and partnering and will remain extremely thoughtful about any potential new M&A going forward.

And last, we continue to drive tech and operations excellence across the board. In mid-Q1, I improved the efficiency of our operations by changing the organizational structure. In the current context, we have paused the hiring of most of our new C-suite. Instead and during this time, our leaders are doubling down. Yet our search for a new CFO in light of Benoit's previously announced departure at the end of June is still underway.

As I said earlier, we took immediate and meaningful measures to further contain costs. Beyond containing our fixed and variable costs, we continue to drive tech excellence and assigned our top employees to the areas and projects that are key to our road map, such as online identification.

And that's a good segue to my fourth point, the latest developments and our work to mitigate the risk beyond -- sorry, around Chrome. As you've heard me say before, we're strong believers in user-personalized advertising and its benefits for all participants in the ecosystem, starting with consumers, publishers and advertisers. In line with our convictions, we've made further progress to move beyond browser control and redefine how consumers can liberate themselves to see personalized, meaningful ads. In doing this, we continue to leverage our direct integration with advertisers and publishers and use their first-party data as a means to create identity solutions for our clients.

This first-party data continues to feed our ID graph, increasing both its size and resilience and providing a massive source of identity data. Our graph continues to grow to well over 2 billion users and now aggregates persistent identifiers like hashed e-mails or logins, for over 96% of these users. We're also investing ways to build and support a user ID network around cookie-less identifies for advertising. Independent of browsers that allow users to manage their consent and preferences. All of this creates a powerful ID spine to help our clients to get the right message to the right person at the right time. With our commitment to supporting consumer choice while protecting their privacy, we're also actively participating in the worldwide web consortium with respect to Chrome's initiatives around cohort-based advertising. In parallel, we'll continue to entertain a constructive dialogue with Google, both about the consequences of the changes being considered in Chrome as well as potential opportunities to partner.

And this leaves the fifth topic, our priorities for the rest of the year. While things are fast changing around us, we remain proactive, disciplined and engaged in our strategic and operating priorities. First and foremost, we stay focused on protecting the safety of our people and guaranteeing the best business continuity for our clients and partners. Second, we'll continue to support our clients throughout the crisis and aim to help them maximize opportunities during the recovery phase. Third, we're hyper-focused on managing our cost base and prioritizing our use of cash. Fourth, we'll look to further our industry lead in shaping the future of personalized advertising. And last but not least, we remain dedicated to executing against the product strategy while staying nimble as the landscape unfolds. This includes leveraging our core strength in direct response marketing and our best-in-class performance solutions to help our clients best rebound from these unusual signs by driving sales for them.

As we head into what's likely a tough recession for the global economy going forward, we believe marketers will increasingly look for valuable, high-return investments that drive sales. A number of industry experts or analysts, including Ratko Vidakovic at AdProfs, believe that top of funnel budgets like brand awareness are more likely to cut -- to be cut in direct response and suggest marketers will prioritize the safer, more measurable and more accountable channels that are typically direct response. A recent survey from advertisers' perceptions shows that 65% of advertisers say, they'll focus more on performance marketing in the COVID-19 context. For this reason, we think our core strength and direct response marketing as well as our strong client relationships, may prove to be the competitive advantages in helping our customers best recover from these hard times.

With that, I'll now hand it over to Benoit to cover our Q1 performance and cost control and liquidity and our financial outlook. Benoit?

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

Yes. Thank you, Megan, and good morning, everyone, from Brittany in France. Let's start our -- let's start with our Q1 performance. I'll then focus on our cost containment program and liquidity position and close with our guidance for Q2 and provide details about how we think about the outlook for the remainder of 2020.

Q1 was a solid quarter amidst a challenging environment. Revenue was $503 million. Revenue ex-TAC, our key metric to monitor the business, declined 11% at constant currency to $206 million, or $207 million using the ForEx assumption for our updated guidance provided on April 1. COVID-19 impacted revenue ex-TAC by about $10 million or more than 4 points of year-over-year growth, as some clients decided to temporarily pause or reduce their campaign with us. About 80% of the COVID impact was with large clients, as spending in the mid-market remained resilient.

The Travel vertical, which was deeply affected by COVID-19, contributed to 40% of the impact and the remaining 60% were evenly spread between Retail, Classified and other verticals.

Currency changes in Q1 contributed to a $4 million headwind compared to Q1 last year, and provided a $1 million headwind compared to our guidance assumptions. Q1 revenue ex-TAC margin was 41%, in line with the prior quarter on our expectations.

Looking at some of our operating highlights. Our new solutions grew 49% to 13% of our total business, increasing 4 points compared to Q1 last year, and now represent close to 20% of our business in the Americas. The solid growth of retail media was a significant driver of this performance. We launched our commerce audiences and similar audiences' solution for web globally. With this solution, advertisers are now able to search and create audiences in self-service based on product categories, on price ranges, brands, customer gender and purchasing power. Our omnichannel business grew over 120% as more clients on boarded offline transaction data to reach their customers online.

Our retargeting product declined 16%, in particular with large customers. About 5 points of this decline or most of the $10 million impact related to COVID-19. We added over 110 net new clients in Q1 and ended March with close to 20,400 clients. This is a 5% year-over-year increase while maintaining a high retention at close to 90% for all solutions. COVID-19 had a significant impact on our same-client revenue ex-TAC, which declined 9% at constant currency, of which 5 points are driven by COVID-19.

We launched Criteo Partners, our global partnership program, dedicated to helping our channel partners to get the training, certification, marketing, support and rewards they need to effectively sell our core product to our small mid-market addressable clients. And from a supply standpoint, more than 4,600 direct publishers are now connected to one of our Criteo direct bidders on web and app. That means that we now connect to about 40% of all publishers we work with via direct bidder. Further, we started to benefit from preferred deals with a large number of publishers running on Google AdX, allowing select advertisers to buy at a negotiated fixed CPM and increasing privileged access for Criteo and our clients.

Turning now to our regional performance. Revenue ex-TAC in the Americas declined 16% at constant currency. This was driven by a $3 million COVID impact -- $3 million COVID impact, in particular, with large customers and in the broader Classifieds vertical. This came in addition to a soft start in January due to clients slowing down their budgets after very high-spend level during the Q4 '19 peak season. At this stage, we expect the COVID impact to get worse in Q2 in the Americas.

EMEA revenue ex-TAC declined 9% at constant currency, driven by a $5 million impact from COVID and the fact that it's the region most impacted by the weakness in Travel. Under these circumstances, our performance in the mid-market across the region as well as our German and Eastern European businesses remained solid and resilient. Our new business was also healthy across EMEA, with new client gains like Roman Originals on UNIQLO. And in APAC, revenue ex-TAC decreased 7% at constant currency, after a $2 million COVID impact, mostly in the Travel and Retail verticals with our South Asian -- Southeast Asian market most hit. Our Japanese business was less impacted than other countries, and Korea continued to grow double digits despite the early COVID outbreak.

Shifting to expenses. Other cost of revenues were up 30%, driven primarily by the opening of a new data center in Japan, by $2 million digital taxes in France, Italy and Turkey as well as lower sales of fixed assets. Non-GAAP other cost of revenue grew 24%. Operating expenses declined 16% on both GAAP on a non-GAAP basis. We spent about $7 million less than planned in Q1 on a non-GAAP base total expense basis, mostly thanks to lower people costs driven by lower headcount, lower sales commission and lower stock price impact on our social charges despite also higher provisions for collection risk and client receivables.

Overall, our non-GAAP expense base reduced by $20 million year-over-year in Q1. We've made it a high priority to effectively adapt our cost base and intend to significantly increase our focus on cost control, productivity and efficiency gain. I'll go over this in more details in a few minutes.

Headcount-related expenses represented 73% of GAAP OpEx, down 1 point. We ended Q1 with 2,700 employees, 4% or about 110 employees less than a year ago, including 64 employees related to the closure of our Palo Alto R&D center in the quarter. As Megan indicated, we do not plan to hire until further notice and have asked all of our teams to be very strict and only backfill certain critical roles on an exception basis.

Looking at our non-GAAP expense now by function. R&D OpEx declined 27%, driven by an 11% decline in headcount to 630 R&D and product engineers after the closure of our Palo Alto R&D center as well as an increase in research tax credit and lower facility expenses. Non-GAAP R&D expenses declined 280 basis points to less than 14% of revenue ex TAC.

Sales and operation OpEx decreased 8%, driven by lower sales commission, a 1% decrease in headcount to about 1,600 employees, lower marketing costs and lower facility expenses, slightly offset by an increase in bad debt. Our quota-carrying sales and account strategies increased by a few heads compared to Q4 to just over 710. Non-GAAP sales and operation expenses increased 170 basis points to 37% of revenue ex-TAC.

And G&A expenses declined 23%, driven by a 5% lower headcount to about 490 employees, lower facilities expenses as a result of the rightsizing of our offices, lower contractor fees and lower expenses for global communications. Non-GAAP G&A expenses were below 11% of revenue ex-TAC, down about 150 basis points.

Adjusted EBITDA reached $59 million or $60 million at guidance rates and stood $2 million above our original guidance for Q1. This drove our adjusted EBITDA margin to 29% of revenue ex-TAC, in line with Q1 last year and highlighting our increased focus on cost control in light of the COVID turbulences.

Depreciation and amortization increased $5 million as a result of Q4 CapEx last year and the accelerated depreciation of the Manage acquired technology.

Equity awards compensation expense decreased 39% and driven by the lower average stock price. Financial expense was nonmaterial. And our effective tax rate was 30%, thanks to the positive effect of the French patent box regime.

Net income was $16 million, down 23%, and adjusted diluted EPS was only down 13%. Cash flow from operations declined 16% to $57 million due to a slightly higher DSO, which drove a negative change in working capital year-over-year, reflecting the early impact of COVID-19 on client payment terms.

CapEx declined 50% and were $10 million below expectations, thanks to optimized server usage. And our free cash flow came out solid, increasing 3% or $1 million to $45 million. Thanks to our resilient cash collection and reduced CapEx and cash taxes, despite a $4 million cash restructuring charge. Our free cash flow conversion rate was strong at 76% of adjusted EBITDA.

Finally, cash and cash equivalents stood at $437 million as of March 31, after spending $18 million of shares repurchased in Q1. We completed our second share buyback program in February. We purchased 4.5 million shares under this program for a total cash amount of $77 million at an average price of about $17 per share.

Let me now go over our cost containment program, our credit risk management and our financial liquidity position. As Megan indicated, we are hyper-focused on managing our cost base and protecting both our profitability and our cash. Since the COVID-19 outbreak, we've planned to spend approximately $77 million less for non-GAAP expenses in 2020 than in prior year, which represents about $46 million incremental savings compared to our 2020 guidance we provided in February. While about 2/3 of these incremental projected savings are employee-related and largely driven by our strict hiring freeze until further notice, we've also planned significant savings in business travel, marketing spend and events, third-party services and hosting costs. We ask all of our teams to strictly enforce our new expense restriction with rigor and discipline. We've also planned significant CapEx reduction by more than 10% of our original envelope for 2020. After these cuts, we anticipate our CapEx for 2020 to represent about 3% of gross revenue.

We've also significantly increased our attention and focus on cash collection and credit risk management. As of March 31, our DSO was up 3 days compared to March 31, 2019 to 62 days. Our commercial and finance teams follow very strict guidelines as to how best manage our collection risk. Besides our focus on collecting cash in a timely and disciplined way, we've immediately tightened our credit management, for example, by systemizing the automatic pausing for all mid-market campaigns reaching a certain budget gap.

From a financial liquidity perspective, we have a comfortable net cash position of $434 million as of end of March, including $437 million of cash on the balance sheet and only $3 million in financial liabilities. In addition, we have immediate access to EUR 350 million revolving credit facility, which combined with our cash position, provides a total liquidity of about $820 million, equating to close to 18 months of expense run rate based on our projected non-GAAP expense base for 2020. Overall, we believe our current financial liquidity combined with our expected cash flow generation in 2020, puts us in a strong position to weather the COVID-19 crisis under multiple scenarios.

I'll now provide our guidance for the second quarter 2020. The forward-looking statements reflect our expectations as of today, April 29, 2020. Before diving into our assumption, I want to acknowledge that while Criteo has weathered several storms before, including the severe 2008-2009 financial crisis when we started operating commercially, the COVID-19 crisis is truly unique in nature and therefore calls for a lot of humility in trying to assess its full economic and business consequences.

With regard to Q2 specifically, this is traditionally our lowest quarter of the year in terms of seasonality for both top line and profitability, and as Megan indicated earlier, is the assumed low point quarter in our mid-case COVID-19 scenario.

Going into Q2, we've seen our April performance decline by about 25% year-over-year on a global revenue ex-TAC basis. Through April, we've seen APAC trend a bit better, while EMEA was still significantly impacted by lockdowns and reaching a plateau in retail. And the Americas continued to see a growing impact compared to Q1.

For May and June and as of the date of this call, we currently assume that the business impact of COVID-19 will get slightly worse, in particular, in the U.S. Overall, we estimate that the COVID-19 impact on our revenue ex-TAC for the entire second quarter could range from $60 million to $65 million. On the expense side, we plan to cut our non-GAAP costs by -- in Q2 by over $27 million compared with Q2 last year, which means incremental savings of approximately $15 million on top of what we -- what was our original plan.

Taking all of this into consideration and as of April 29, we expect revenue ex-TAC to be -- for Q2 to be between $140 million and $147 million on a reported basis, translating into a year-over-year decline of 32% to 35% at constant currency. Due to the significant depreciation of many currencies a headwind to reported growth of about 230 basis points or about $5 million.

On the profitability side, we expect the significant COVID-19 impact on our top line to translate into an adjusted EBITDA for Q2 in the range of 0 to $7 million. As usual, the ForEx assumption supporting our guidance can be found in our earnings release.

With respect to our business outlook for the year -- for the rest of the year, we withdrew our guidance for fiscal year 2020 on April 1. Given how fluid the situation still is and the many unknowns at this point, we believe we are currently not yet in a position to reliably quantify the COVID-19 impact on our financial results beyond the second quarter 2020. We will, therefore, not provide guidance for revenue ex-TAC on adjusted EBITDA for fiscal year 2020 until further notice. However, I'm happy to share some of our current assumption for the second half of 2020.

As of the date of this call, we are currently modeling a progressive recovery in the second half of the year, with a high 20s percentage decline in Q3 and a high-teens percentage decline in Q4 on a revenue ex-TAC basis, reflecting a slightly larger COVID-19 impact for the entire second half than what we currently expect for Q2 alone. This is our best view as of today and assumes a progressive recovery for non-Travel clients and a much longer and slower recovery pace for Travel. Again, I want to establish that given there is still a lot we don't know, the breadth in the variability of potential outcomes of our current projection is quite meaningful and highly dependent on various assumptions, in particular, the recovery pace by vertical.

On the expense side, we anticipate to spend approximately $30 million less in non-GAAP expenses in the second half compared to the prior year period or an incremental $24 million saving on top of what was already reflected in the guidance provided on February 11, 2020. Most of these savings are headcount related. We intend to closely monitor our expense base and we will look into further expense reduction opportunities to protect our adjusted EBITDA and maximize our ability to generate free cash flow in 2020 and beyond.

Last, with regard to capital allocation, our Board has authorized a new buyback program of up to $30 million to meet our equity obligation to employees while taking advantage of the very low price of our stock. We intend to use all of the shares to be repurchased under this new program in connection with employee equity grants and vesting, in order to limit future dilution for our shareholders. In fact, as set forth in our proxy that we filed yesterday in connection with our employee equity request to shareholders, we are committing to not incur any additional dilution with respect to our employee equity program between the June 2020 AGM on the date of our 2021 AGM.

Let me now close with a few personal words about my departure from Criteo at the end of June. It was a heartbreaking moment for me to decide to leave because I have so much passion for Criteo. Yet, after 8 years and a full cycle from scaling the company by more than 10x from where it was when I joined to taking the company public, now adapting the company model to a different growth profile, I think it's now about time for me to move to a new challenge. Together with Megan, I'll ensure that we identify a great successor and manage the transition smoothly. It's been a wonderful ride for the past 8 years. Criteo is an amazing company with truly unique assets and incredible talent. And with Megan at the end, Criteo is in very good hands.

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

Thank you very much for that, Benoit. I really appreciate it. Before wishing Benoit all the best in his future new endeavors, I want to thank him for the extremely valuable business partnership he's provided the executive team and myself since we started working together. I also want to emphasize that we're focused on hiring the right successor, and we'll proactively manage the CFO transition with Benoit and his strong leadership team in the interim.

In closing, we delivered a strong performance in Q1 amidst unprecedented business context. Our Retail clients hold up well. Our mid-market business is healthy and resilient. Our retail media solutions proved countercyclical in helping brands and retailers leverage the rise in e-commerce. The entire company is all hands on deck to successfully navigate these uncertain times while helping marketers best rebound through best-in-class direct response marketing. And we have unique assets and a robust financial position to come out strong -- healthy and strong we continue to expand our portfolio and to leverage Criteo's core strength to best position us for the future. And with that, we'd now like to open up the floor for questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

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

Kate, this is Edouard speaking. Given the length of the prepared remarks, we'll likely push the call to 9 and 10 minutes, to slightly by 10 minutes. That's a useful focus.

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

That is fine.

Operator

Our first question is from Nick Jones from Citi.

Nicholas Freeman Jones - *Citigroup Inc, Research Division - VP & Analyst*

Just one kind of follow-up on the comments about growth in the mid-market new solutions. I guess, first, what are you hearing from your mid-market clients? A lot of the headlines are indicating, the small and medium-sized businesses are feeling a lot of the pressure under COVID. So I guess, what are you seeing as you go into 2Q in the mid-market? And then what are your clients' appetite for new solutions kind of going into 2Q after having a pretty solid 1Q on the new solutions segment?

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

Let me start with this one, and Benoit, if you want to weigh in, feel free.

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

Yes.

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

Certainly our mid-market clients, we're seeing -- that's a healthy segment for us. And I think it's because that for our mid-market clients, it's slightly more geared towards Retail. And e-commerce and Retail are actually faring better than most, I guess, as much as you can fare in these circumstances. So what we see from them is opportunity. We are looking globally at the ability to expand out our services to a wider range of mid-market clients. Today, we're sort of around what we would call the torso, if you like. So we want to take that out to the smaller players as well.

And let me keep reminding that circling around Retail. It's 70% of our business. So in this environment, it is actually performing as pretty strong for us. We're listening very closely to them, looking for ways in which we can assist them. And one of the things that we have launched is a Criteo partner program, a reseller program, which Benoit might have spoken to briefly before, where we can have resellers take our targeting services out to even smaller clients and educate how to utilize targeting themselves. We provide training and everything that goes with that. But now is a good time for e-commerce, now is a good time for performance-based marketing, and now is a really good time for mid-market retailers. So it's a bit of a shining light for us.

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

Yes. What I would just maybe add is also our mid-market clients, Retail clients are more pure e-commerce players than our large Retail clients who also have large brick and mortars. And while the large retailers with the brick-and-mortars operation have been suffering more. What we see is that the smaller retailers pure e-commerce have been benefiting for increased traffic and e-commerce on one hand. On the second aspect I would highlight also is the fact that we believe that mid-market enjoyed also a greater and cheaper access to media supply in the current environment, that has also contributed to the performance. And what we see beginning of Q2 is midmarket continuing to be strong and resilient.

Operator

Our next question is from Lloyd Walmsley from Deutsche Bank.

Gregory Schweitzer - *Deutsche Bank AG, Research Division - Research Associate*

This is Greg on for Lloyd. So I'm just trying to get my arms around the 2Q guide a little bit better. Is there any way you can tell us what -- at what rate the business exited the second half of March? And then how does that compare to the April growth rate? And I guess, why exactly are we assuming that it necessarily gets worse in May and June? And then just on the Travel point, I think you mentioned, it's down 95%, and you expect it to rebound slowly over the course of the year. But can you give us a sense of maybe where that percentage is now and like maybe just try to better understand the cadence of the rebound throughout the year?

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

Yes, maybe, Megan, if you want to compile -- take that one? So if we look at the trends that we've been observing, obviously, quite dynamically and we continue to observe on a daily basis, what we've seen is April trended globally around 25% year-on-year, with some stabilization in EMEA and APAC. But at the same time, we anticipate that we've not reached the bottom yet in the U.S. And I think if you -- if we look at the -- how we believe the rest of Q2 will emerge. We believe that the U.S. is going to continue to deteriorate and will reach only its lowest points towards the very end of Q2. And that -- the primary, I would say, set of assumptions that we take -- we took behind our Q2 guidance.

With respect to the evolution for the rest of the year, I mean, obviously, I've provided the details as to the various assumptions that we took overall for the rest of the year. We are assuming that we would be still in decline in the 20s, in the mid-20s for Q3, and in Q4, getting a slow recovery towards the mid-teens with variance between verticals where we would see a more rapid recovery in retail, while we expect that Classified as well as Travel would take longer to recover.

Operator

Our next question is from Dan Salmon from BMO Capital.

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

All right. I had 2, I guess, 1 for Megan, 1 for Benoit, and somewhat related. Megan, my question for you is that I would imagine prior to interviewing and considering this position and certainly once you became fully engaged with it, you have likely been thinking about some big longer-term plans you've shared some thoughts on your game changers already. What my high-level question is, in light of the pandemic, how would you characterize how much you need to reel in versus a plow ahead on some of those initiatives? I'm sure that's something that you and JB have been discussing at a high level about how to approach the repositioning of the company in a time like this, and I'd love to hear just your high-level comments on the balance between those more.

And then Benoit, from your position as the CFO, you gave us a lot of detail on revenue and expense management. I guess what my question is it's a bit of a broad one to you as well. When we look at the guidance for flat to slightly up EBITDA, how much do you see your ability to essentially manage the free cash flow and help, like I said, provide the backdrop for whatever continued investment Megan was looking for in the company during a very trying time? I hope that makes sense.

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

Thank you, Dan. It always makes sense. Hope you are staying well. Let me jump in here. Yes. So walking into this role was one thing, looking at it through fresh eyes in a COVID environment is definitely something else, and it's prudent of my job to make sure that we're heading in the right direction. We went down a pretty clear path of moving into a full stack DSP, which is what our clients have been wanting from us and what we think has been missing in the market, and we continued to focus on that as our path forward.

But if you step back a little bit and think about the new norm and how advertisers are adapting, I guess that gives you a chance to just reflect on the assets that we have and the behaviors that we see. And I think this opens up questions to me around the strength of a retargeting business. I happen to think it's going to be stronger coming out of this, the notion of performance-based marketing, the notion of large clients having to drain stock from shelves and go more promotional, the changes in the TV environment. All of these things point towards doubling down actually on making sure our retargeting business is everything that should be to service both large clients and mid-market clients.

What that actually looks like needs more focus, but it still is in line with the investments that we're making. And then the thing that's really exciting to me is long term, so what does the world look like when we come out of this; there's areas that I think we should focus more on, which we haven't perhaps thought of in terms of our strategy around personalization and just pushing this Chrome stuff and third-party cookie stuff to one side and doing it completely differently. Do we have the assets and strength and market relationship to do that? Yes. What about performance?

As I just said, performance marketing, doubling down on that, do we have the asset strength and market relationships to do that? Yes. E-commerce; enabling e-commerce through retail media and others. Do we have the assets? So all of these things, I think it's time to just look at them and say, well, this is sort of -- it is going to be different. We have powerful assets. We have the ability to grab market share in areas that are right for it when we come through into the new norm. Will it change the strategy? Not likely. It will probably just change the speed in which we focus on different parts of that strategy. And that's we assess every single day. But right now, we have a new lens to look through and make no mistake, that's exactly what we're doing. It's a good question. Thanks, Dan.

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

So Dan, just to follow-up on the way we manage with a longer-term view of free cash flow and expenses, as you've seen, I mean, we've been -- we took immediate measures, sizable measures in order to protect our profitability and protect our cash flow. And I think with this crisis, it's -- it requires us to further accelerate and double down in our operational excellence so that not only we protect our profitability and our cash flow generation, but we ensure that the company is best positioned as we will go out of this crisis to allocate our resources on the strategic game changers, be it organically through partnership and emerge as a stronger company after that crisis, having doubled down and our focus on operational excellence and cost control.

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

If I can just sneak in one follow-up. Google recently announced some changes to their Google shopping platform. And Megan, you mentioned the new Retail Media product that you expect later this quarter. How do you see that in competitive environment changing for a new important key product and part of that game-changing plant for you?

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

Yes. I think one of the underlying ideals of Criteo, what we fight for is the open Internet. And enabling retailers, enabling brands enabling anybody around e-commerce and shopping to be able to utilize platforms off the big walled garden. Now I say that with respect to the walled gardens, but there's going to be something else as well. And so again, competition is our friend. Competition will enable us to really understand what it takes to service those that don't necessarily want to use the shopping platforms that the walled gardens have. And so it's a positive sign for us. There's positive reinforcement for our investment in that area. We're clearly doing -- clearly going after the right things.

Operator

Our next question is from Tim Nollen from Macquaire.

Timothy Wilson Nollen - *Macquarie Research - Senior Media Analyst*

Two things as well for me, please. One, interesting to see the strong growth in the new products, the App Install business and things, and that makes sense. My question is how willing are clients to engage in these newer things? I suppose somewhat experimental for them. And this is not necessarily a time for experimenting. So I'm just curious sort of -- it's nice to see that traction. If you could just speak a little bit more to where that can go and how willing clients are to be engaged in these new things, App Install and Retail Media and so forth. The second question is for Megan as well coming from Nielsen and seeing this interesting announcement about the partnership with Nielsen on DAR. I wonder if you could just explain just a touch more kind of what that does for you. What did you -- how does that help Criteo's business going forward?

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

Yes. Good questions. Thanks, Tim. So in terms of new things, marketers have new problems. And so it's less about a sort of discretionary, let's dabble in some new toys. It's more about how do I get the -- what do I need? What tools do I need? What platforms do I need to get the right message out to the right person at the right time? And particularly given this environment, how can I do that most effectively. And so App Install is a perfect example of that, whereby there's a channel for brand owners, for advertisers to get to consumers and it's on the phone, right in front of people who are spending more time on the phone than they ever have. And so it makes a ton of sense for them to move towards things that are going to help them with their business rather than just be something that they experiment.

So that's the sort of trend we've seen in terms of App Install. And I think the same applies to retail media as well, how do I utilize a network to be able to create a shopping environment. And that's just as a response to a need. And so we're proud that we can service those needs, and we'll continue to talk to clients and look at the marketplace for new opportunities for us.

On the Nielsen side, well, look, I love this one. Nielsen, our currency provider, third-party independent measurement provider, it's important for us to make sure that our clients have transparency into what it is that we provide them beyond performance, but also that they know that they got to the right person. And that's what Nielsen does. It's just layer on an extra piece of third-party validation that the work that we've done -- that they've got what they paid for, put it that way. And both in terms of ad ratings. Ad ratings is a powerful one because it's able to measure an advertiser's reach, if you like, across platforms that's able to compare what we do for them in a digital environment to their campaigns as they run across TV, that's an incredibly powerful thing. And also in digital brand effect that shows what the uptick of the brand -- the brand equity was? Or do I remember the brand? Does it change my decision set to purchase, et cetera? So these sorts of metrics that we don't necessarily provide that we think a fundamental add-ons to performance to actually sell a product. So I love this one, clearly, for obvious reasons, and I do hope that and feel good about a deeper and wider relationship with Nielsen.

Operator

Our next question is from Andrew Boone from JMP Securities.

Andrew M. Boone - *JMP Securities LLC, Research Division - VP & Research Analyst*

On mid-market and new clients, are there any trends to the client adds that you're seeing? Is this brick-and-mortar companies finally coming online? Or is it more new business formation? And then how sustainable is that as you think about these trends into 2H '20? Secondly, on publishers, are -- does COVID make a more direct relationship more attractive? And how does that change how you guys think about cookies going forward?

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

I'll take it, unless you want to take the first one, Benoit, I can do that.

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

Yes. Go ahead. Go ahead.

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

Okay. So your question, I think, was about the trends that we're seeing in new clients around mid-market. I think you're -- there is a real push towards e-commerce. And as I said before, the -- our mid-market clients are heavy retail, and they are heavy e-commerce. What we're seeing, I think, is the reaction to the environment that we find ourselves in at the moment is that the brick-and-mortar is struggling. And so brick-and-mortar needs to move into e-commerce and needs to move in fast. And so when we see clients coming from that side, not just large clients or mostly mid-market clients, I should say, these are mostly mid-market clients. But also more and more mid-market clients do realize that brick-and-mortar is unhelpful to them right now and that they have to increase their e-commerce profile. And because of that, we're seeing an increase in mid-market clients coming to us for performance-based advertising. So look, I think it's not just a sign of these times and where we are right now. But it is a sign of the new role going forward because unless you think that we'll come out of this and everyone will go back to the way they were before, then I got to think that e-commerce presence will more sustained past this. And so we feel good about the move of mid-market clients to us in terms of driving targeted direct response advertising. Your second question, I apologize. Can you just -- it was to do with Chrome, but what was the first part of that so that I get it right?

Andrew M. Boone - *JMP Securities LLC, Research Division - VP & Research Analyst*

As I think about publishers and CPMs down broadly across digital advertising, are you finding that publishers are leaning into a more direct relationship with Criteo and that's helping move away from kind of third-party cookies to a first-party access?

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

We are seeing more publishers coming on board, which is always very healthy. Our network of relationships between publishers and the buy-side and the sell-side is getting stronger. I would like to think that if there is a relationship between that and Chrome, it's one where publishers understand that they need to have a direct relationship or more of a direct customer relationship with the consumers or with their audiences that they do need to also have that to be able to have that link between them and advertisers. And that they see that we provide a backbone, spine, if you like, that sits in the center that can link those 2 places.

I do think that the advertising, the Internet is about one-to-one advertising, but respectively do one-to-one advertising, you have to have a relationship with the consumer. And you have to have one that gets you the information that you can link yourself into a network. And so I think publishers are protecting themselves by staying relevant in and an open Internet environment by being able to continue to get the right message to the right person at the right time in a contextual way. And to make sure that they can free themselves up from an environment where the browser dictates what consumers can and can't do. It's a really healthy sign for the industry, and I would expect we'll see more of it.

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

Well, thank you, Megan. Thank you, Benoit. This now concludes our call for today. The IR team is available for any additional question or follow-ups you may need. So we'd like to thank everyone for attending the call. Wish you a good end of day and hope you all stay and healthy. Thank you.

Operator

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