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TRVG.OQ - Q2 2017 trivago NV Earnings Call

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PRESENTATION

Operator

Good day and welcome to the trivago Q2 earnings 2017 conference call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Mr. Matthias Tillmann, head of Investor Relations. Please go ahead, sir.

Matthias Tillmann - *trivago N.V. - IR*

Thank you. Good afternoon, everybody. Welcome to trivago N.V.'s financial results conference call for the second quarter ended June 30, 2017. I am pleased to be joined on the call today by Rolf Schroemgens, trivago's CEO and Managing Director and Axel Hefer, our CFO and Managing Director.

The following discussion, including responses to your questions, reflects management's views as of today, August 4, 2017 only. We do not undertake any obligation to update or revise this information.

As always, some of the statements made on today's call are forward-looking, typically preceded by words such as we expect, we believe, we anticipate or similar statements. Please refer to today's press release and the Company's filings with the SEC for information about factors which could cause our actual results to differ materially from these forward-looking statements.

You will find reconciliations of non-GAAP measures to the most comparable GAAP measures discussed today in our earnings release, which is posted on the Company's IR website at IR.trivago.com. I encourage you to periodically visit our investor relations site for important content, including today's earnings release.

Finally, unless otherwise stated, all comparisons on this call will be against our results for the comparable period of 2016. With that, let me turn the call over to Rolf.

Rolf Schroemgens - *trivago N.V. - CEO*

Yes, welcome, everybody. Thanks for joining our Q2 earnings call. So yes, we were looking back on a very busy quarter with lots of innovation in actually all areas of the business. Marketing, as well in our hotel search product and also in advertiser relations and I think we are very proud that we keep the organization vibrant and fast learning. The recent introduction of our new leadership model was a very good example of that. And we are very happy that we can look back on a very strong quarter.

The second quarter 2017 actually exceeded again our expectations in terms of growth. With 67%, we kept the strong growth ratio from the previous quarter and we actually massively accelerated our growth looking at the same quarter last year. We have grown our revenue from EUR179 million to EUR298.3 million.

Looking at the first half of the year, we have also grown 67% to a total revenue of EUR565.9 million and in line with our strategy, we reinvested our profitability into further growth by still nicely increasing our EBITDA to EUR3.2 million, up 39% from Q2 2016. Looking at the full first half of 2017, actually our EBITDA went massively up about 125% to EUR22.5 million.

Looking at our geographical diversification, we see that it's still ongoing, so we have seen very, very strong growth in the rest of the world markets and the segment itself increased to close to 20% of our overall revenue. Americas kept their share at about 39% while developed Europe, still growing strongly, went down to 42% of our revenue.

We were saying that already in the last earnings call, and we will discuss -- every quarter, we will discuss one special topic in our earnings call. Last quarter, we actually spoke about the new developments in our marketplace and this quarter, we will focus on the supply side and speak about our advertiser relations initiative.

The advertiser relations pillar is a part of the organization that fuels our search with content and rates. We believe that only if you are providing a really perfect search experience then -- or when you really want to provide a perfect search experience, you have to give users full market transparency. They should easily see that they can book their ideal hotel for the lowest rate.

So comprehensiveness of the offering is a huge factor and we also think it's a huge differentiator. And to be comprehensive, you have to collect all bookable rates from online booking sites, hotel chains, as well as from individual hotels and show them in a very simple to digest format.

If you are looking at our overall purpose, a strong motive in trivago's purpose is empowerment. So we want to empower our users. We want to empower our employees and we also want to empower advertisers.

When we generally speak about advertisers, we refer to all categories. So we are speaking about the 180 plus booking sites, we are speaking about the 230 plus hotel chains and also about the more than 11,000 individual hotels.

To empower them, we provide them with expertise, with marketing tools and with enabling technology. Examples on the last advertiser side are tools like trivago intelligence with which we democratize information around exposure, rates and bidding. Trivago automated bidding where we help advertisers to find the best bid for each individual hotel and trivago Express Booking where we provide advertisers with the booking funnel technology that can compete with the large OTAs.

On the individual hotel side, we empower through tools like trivago Hotel Manager to manage hotels' exposure on trivago and to do their marketing on trivago, Base7booking, booking a cloud-based operating system for hotels and also the new My Hotel shop product to optimize online advertising.

So our advertiser relations teams managed over the last 12 months to massively grow the number of booking sites and hotel chains that offer their inventory on trivago. And as a consequence, that led to the fact that we were able to increase the number of hotels listed on trivago by more than 86% to 1.8 million properties.

In the same time, we were able to keep the number of rates per property very stable at around 10 rates per property. So keeping in mind that we added a form of long-tail inventory, which usually comes with way less rates per property, that's way better than you could expect actually. So we achieved this by raising our rates inventory in the same time span by more than 97%. So looking at the nature of the added inventory, that means that we significantly increase the competition on our high-traffic hotels.

So taking a closer look at the tools that we provide, we can see that our approach to support advertisers with technology for their booking funnel is getting more and more traction. So we are able to create very positive cases in which we actually see how we can make small advertisers way more competitive than they have been in the past.

The number of advertisers using automated bidding increased by more than 60% in the last six months. So also the growth ratios for our tools for individual hotels developed very nicely. We have now more than 300,000 hotels directly registered for our free Hotel Manager tool, which represents actually an increase of 96% in the last 18 months. And on a smaller base, our paid subscription product, Hotel Manager Pro, grew more than 300% in the same time.

So to summarize, our advertiser relations team really delivered on its mission. They were able to improve the search experience by increasing our hotel inventory massively. They increased competition on our marketplace by significantly growing the number of rates. They empowered our advertisers to be more competitive in the marketplace and they improved massively the participation of individual hotels.

So many thanks for listening to the small update and I would now like to hand over to Axel to give you some more detail on the financials.

Axel Hefer - *trivago N.V. - CFO*

So as Rolf mentioned already, the second quarter showed very significant growth at 67%, reaching EUR298.3 million. We continued to benefit in the second quarter from the relevance assessment and we reinvested profitability into growth. So as a result, the adjusted EBITDA went up by 39%, reaching EUR3.2 million in the second quarter. The net income in the second quarter was negative at EUR3.4 million, an improvement from a loss of EUR49.9 million the year before.

So looking at the return on advertisement spend, in the second quarter, we saw a slight decline from 115% to 113%. In the first half of the year, it was flat at 117%. The adjusted EBITDA margin, so we saw a slight decline from 1.3% in Q2 to 1.1% in Q2 this year, whereas the first half showed an improvement of 3% to 4% in 2017.

If you look at our KPIs, qualified referrals grew by 59% in the second quarter, reaching EUR196 million. The revenue per qualified referral continued to benefit from the relevance assessment and grew by 4% compared to the previous year reached EUR1.5 and the return advertisement spend, as I mentioned before, declined to 113%.

If we look at developed Europe, the qualified referrals increased by 34%, reaching EUR82 million in the second quarter. The revenue per qualified referral increased by 7%, reaching EUR1.47 and the return on advertisement spend declined by 4 percentage points reaching 124% and was impacted by a mix effect through a very strong growth in our performance marketing channel.

In Americas, our qualified referrals grew from 33 million to 52 million. Our revenue per qualified referral improved by 7% from EUR2.08 to EUR2.23 and the return on advertisement spend increased by 3 percentage points to 117% in the second quarter.

Rest of the world, we saw very strong growth in qualified referrals at 114% reaching 62 million in the second quarter 2017, an improvement of 12 percentage points in revenue per qualified referrals reaching EUR0.94, and an improvement of 5 percentage points in the return on advertisement spend showing a very strong brand aftereffect in that quarter.

So coming to our guidance, we confirm our annual guidance of around 50% revenue growth and slightly improved adjusted EBITDA margin. We expect a deceleration of growth in the second half compared to very strong quarters in 2016. As anticipated, advertisers reacted to our relevance assessment at the end of the second quarter. As a result, the revenue per qualified referral levels normalized. This reaction has led to an improved user experience, which we expect to improve retention going forward.

In July, we started to modify our traffic acquisition strategy to improve traffic quality and conversion. Initially, this will slow down our qualified referrals growth, but ultimately leads to higher revenue per qualified referral.

On the individual quarters, we expect the revenue in the second half of the year to be significantly more weighted to the fourth quarter. The adjusted EBITDA in the second half of the year will be to more than 100% coming from the fourth quarter.

Matthias Tillmann - *trivago N.V. - IR*

We are now open for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Brian Nowak, Morgan Stanley.

Brian Nowak - *Morgan Stanley - Analyst*

Thanks for taking my questions. I have two. The first one, just going back to the final weeks of June and what you saw in the cost per click bid normalizing, can you just talk about what your expectations are on revenue per qualified referral region by region or how to think about the potential of that in the guidance right now from what you've seen in June?

And then the second one, Axel, just going back to your comments around optimizing performance, marketing mix and the potential slowdown in qualified referrals, can you just talk about what you are changing, where you are changing and how you think about that impacting the model now and then over the long term?

Axel Hefer - *trivago N.V. - CFO*

Yes, sure. So the impact of the relevance assessment that we talked about last quarter already, we saw pretty much the same effect in the second quarter and we expect the revenue per qualified referral to basically go back to old levels. So this positive effect that we had in Q1 and Q2 to go away for the full third and fourth quarter. That's to your first question.

To the second question, Rolf, do you want to take that?

Rolf Schroemgens - *trivago N.V. - CEO*

Yes, so I think if you are looking at it from a more theoretical point of view, so if you would ask like what is the ultimate goal of user acquisition, there can just be one answer to what should be the target and the answer is lifetime value of a customer. So that is what we have to optimize for ultimately.

The nature of our business doesn't let us do that because we don't have -- of course, we don't have full data on that. Nobody has, but we are, as a search, in a situation where we basically have a long way to go there.

So what will happen over time is, of course, generating more data, generating more learnings, we will always take a more long-term perspective on user value. We are looking beyond the session, looking beyond the visit and beyond the day users came to us, but taking a more long-term view on it.

And taking a more long-term view also changes the mix. The more long term we are looking at our performance channel, that must ultimately change the mix of our campaigns and that is something that we continuously do, so we continuously try to get more long-term oriented in the way we acquire customers and that sometimes leads to also step changes in our attribution and one of these step changes happened now with the third quarter.

Axel Hefer - *trivago N.V. - CFO*

So to add to that just because I think I didn't fully answer your question, technically, what we assume as a baseline is basically flat revenue per qualified referral by region. And so on a region level, this positive effect will go back, so will be again more comparable to the previous year period; whereas we expect a positive impact, not in the third quarter, but in the outer quarters of the change in our traffic acquisition strategies across all regions.

Brian Nowak - *Morgan Stanley - Analyst*

Okay, great. Thanks.

Operator

Lloyd Walmsley, Deutsche Bank.

Lloyd Walmsley - *Deutsche Bank - Analyst*

Thanks for taking the question. First one, just following up on your last point you made on the step function change in attribution. Can you elaborate a bit on what exactly that is and clarify whether that is an attribution improvement in your own marketing or for your customers in terms of their spend on trivago?

And then, I guess, somewhat related, you seem to have managed to get OTAs to use property-specific landing pages instead of landing users on search results page, which is abnormal for their behavior historically on other channels. So curious how you think about your ability to have gotten them to do that. Is it simply just the quality score or are they seeing other benefits in their business because I would think they historically have liked to get people using their search and then optimizing their landing pages to perhaps upsell users?

So curious, it seems like a big -- you've been able to enact a big change. Besides the pricing carrot and stick, what else -- I guess what else do you think they are seeing as a result?

Rolf Schroemgens - *trivago N.V. - CEO*

Okay, thanks a lot for the question. So let me first answer on the marketing side question. So when we speak about we change our marketing mix, it's really our marketing. So it's like how we acquire customers and what we do there is we are taking always like a more long-term view on things.

So right now, for example, we change our attribution model and looking now not only on bookings alone, so bookings right now for us, the value generation, which is more bookings and for us revenue that we generate play a larger roll now in our attribution. And not only the bookings that happen in the session, but also happen over a longer time span. So that is a change that we have leading to the fact that ultimately on short term, there is less revenue coming in but more value generated, but then of course the marketplace has to react to that more value that is generated. That happened in the past; it is always coming with a delay, but that is what we are assuming that will happen in the future. So that is the marketing part.

Regarding the landing page experience, so I think there is a difference because I mean we ultimately have to serve our users best and we have to maximize the whole experience. So we cannot look at a single advertiser and when a single advertiser optimizes their experience, it's a difference by -- or it's not always optimal. So the optimum can only be reached if we optimize the experience of the users on the whole marketplace and that might differ. So the landing page there might differ, so we have to incentivize our advertisers in a way that we optimize for the perfect marketplace experience. And that's what LPS, landing page score, is for. We try to make this a variable in the optimization of our advertisers and we are using different kinds of tools to do that.

We also are optimizing that and developing that further step-by-step, but, at the end, it's an optimization for user value -- for a user that comes to our marketplace and wants to get the perfect experience from that marketplace. And for that, it's just like -- for the users, it's often annoying. When they already decided for a rate on trivago, and then they are forwarded, for example, to a landing page where there are lots of results, they get maybe disturbed. They might even stay there, go to another hotel, but they don't find what they would expect from us and we have to deliver them their perfect experience. Meaning we have to directly deliver then to their respective rate and where they can really easily book it.

And I think that is something that we are trying to do here to optimize for our users and to give them the best marketplace experience and not individual advertiser experience.

Lloyd Walmsley - *Deutsche Bank - Analyst*

Thank you.

Operator

Mark May, Citi.

Mark May - *Citi - Analyst*

Thanks for taking my questions and good morning. Just one clarifying question on your prepared remarks regarding second-half EBITDA. I think the readthrough on that is that you are guiding for an EBITDA loss in Q3. I just want to clarify that that's the right way to interpret your comment.

And then in terms of the Americas segment, the slowdown in qualified referrals, I mean still significant growth obviously, but slowed down both on absolute and percentage terms. Wondering if you could comment a little bit about what is going on there, what you are seeing in those markets and what kind of contribution are you seeing in LatAm, which seems like was probably pretty strong during the quarter. Thank you.

Axel Hefer - *trivago N.V. - CFO*

So first question, you're right, we expect the adjusted EBITDA to be negative in the third quarter and then to be overcompensating that in the fourth quarter. Trends in Latin America, we don't disclose subsegment information or even country-specific information, so that is something we cannot comment on.

And in terms of Americas segment slowdown in qualified referral growth, I would like to make a general comment there. We manage the business on an annual basis and we are still growing very, very fast. So to purely look at quarters is sometimes a bit misleading as you need to look at a slightly longer period there.

So I would caveat the development of the individual quarters to a certain extent. But, in general, we still see a very positive development in Americas and there across all the markets.

Mark May - *Citi - Analyst*

Is it possible to provide a little bit more commentary on what's driving the Q3 EBITDA loss? Is it TV or performance? Is it certain regions that you are pushing harder in? Any additional commentary there?

Axel Hefer - *trivago N.V. - CFO*

Yes, so on the comments that we made already, I guess what you have as an impact on the third quarter is the normalization of the revenue per qualified referrals, which obviously has a top-line effect, but at 100% margin. So that is something to keep in mind when looking at the third quarter. And then the second point is obviously the adjustment in the slowdown in qualified referral and then the subsequent increase in revenue per qualified referral, which obviously has a negative margin impact in the short term as well because your revenue comes down, but your traffic acquisition stays the same because there is just a time lag effect in the change of the pricing dimension and the volume dimension.

Mark May - *Citi - Analyst*

Thanks.

Operator

Douglas Anmuth, JPMorgan.

Douglas Anmuth - *JPMorgan Chase - Analyst*

Thanks for taking the question. Can you guys just talk a little bit about Europe in 2Q specifically and just the drivers around the lower ROAS year-over-year and specifically more on what you did with TV and the performance marketing shift that took place? And then also it looks like your related party spend just as a percentage of revenue was down a few points from recent quarters. Can you comment on that around Expedia and if there is something going on with them or perhaps some of your advertisers, other advertisers stepping up more? Thanks.

Rolf Schroemgens - *trivago N.V. - CEO*

So on the second quarter in Europe, so the return on advertisement spend has come down and the reason for that is that the investment into growth is faster in a way and is easier to scale in performance marketing channels. So we scaled up our investment, but the impact of that scaling up the investment in the second quarter was more immediate in performance marketing. And as a consequence, the share of performance marketing channels in our traffic mix and spend mix increased. And given that their profitability is lower than in the branded channels, the profitability has come down. So it is -- 100% of the effect is actually coming through the change in mix.

In terms of related party share down, I mean the related party share is the consequence of billions of individual bids and so there is nothing fundamentally changing; it's the outcome of a lot of different auctions. And so, in a way, it just shows the end result of the marketplace in a way.

Douglas Anmuth - *JPMorgan Chase - Analyst*

Okay, thank you.

Operator

Kevin Kopelman Cowen.

Kevin Kopelman - *Cowen and Company - Analyst*

Hi, thanks a lot. So really just a couple of follow-ups. The first one is, when we think about EBITDA in the fourth quarter and some -- I think that looks like it's going to be higher than maybe it was expected earlier. Is that driven more by returns from the ad spend in the third quarter given the new optimization or is the reduction -- or is there a reduction in investment planned in the fourth quarter? And then I have another one.

Rolf Schroemgens - *trivago N.V. - CEO*

So I think when you are looking at -- when we spoke about the reasons why we see rather the third quarter coming in a little bit lower and the fourth quarter higher, basically it's both are things that we recently introduced where we see rather short-term negative impact and long-term rather positive impact. That's true for LPS, so of course we do LPS to, in the long run, see a positive impact from LPS. And that's what we expect.

And of course, we change our marketing mix because we expect also profitable -- a positive impact on profitability; otherwise you wouldn't do that. And both comes with a time lag and that's why you have a shift towards the fourth quarter. That's why we expect it.

Kevin Kopelman - *Cowen and Company - Analyst*

Okay, got it. That's helpful. And then one more question, can you give us any more color on reaction of users since you implemented the relevance assessment given that that should have improved the user experience? What are you seeing?

Rolf Schroemgens - *trivago N.V. - CEO*

So I mean it's still early, first of all, but what we see is definitely grown into action. And what we have seen in test is also, of course, like a grown retention of users. But that's from the early test and that still has to be proven.

Kevin Kopelman - *Cowen and Company - Analyst*

Okay, thanks, Rolf.

Operator

Peter Stabler, Wells Fargo Securities.

Peter Stabler - *Wells Fargo Securities - Analyst*

Thanks, two if I could. First of all, wondering if you've seen any impact in the market based on the changes by TripAdvisor, any indication that there is more meta-click supply in the market and that that's beginning to be reflected in bidding behavior. Secondly, hoping you could comment on the participation rate of individual hotels in the auction of the 310,000 who are now on Hotel Manager and the smaller group on Manager Pro. What are you seeing in terms of trends or participation rate? Thanks.

Rolf Schroemgens - *trivago N.V. - CEO*

Okay. So looking at our top line, we don't see impact at all from what TripAdvisor does. So looking at our visitor numbers, our branded visitor numbers, they seem not to be impacted. So currently no positive impact on our side as well as no negative impact, so we just see not an impact. We cannot see that.

Axel Hefer - *trivago N.V. - CFO*

So coming to your second question, going through the different metrics, so as Rolf has presented, we have significantly grown the number of users of our Hotel Manager, basic version and the professional version. And the way we think about it is basically conversion funnel. And so in terms of participation of individual hotels in marketplace auctions, it's still early days, but we believe and we see that it is actually a long process where you first need to build a relationship, which is what we do with the Hotel Manager product. Then we invest into the online sophistication of the hotels, which we do through the Hotel Manager Pro. And then the third step is only a participation in the marketplace, which, as of today, is still relatively speaking limited. And we think that it will be very, very important in the long term and a great strategic asset in the long term. But it is a process that takes some time and it is important to basically build the funnel at each of these three conversion steps.

Peter Stabler - *Wells Fargo Securities - Analyst*

Thank you.

Operator

(Operator Instructions). Shyam Patil, Susquehanna.

Unidentified Analyst

Hi, this is Brandon on for Shyam. I just have a couple quick ones. First just how do you feel about your mix of hotels versus OTAs in the advertising business and what would you like to ideally see this mix over time? And then just one quick unrelated one. With the EU ruling against Google Shopping, are you seeing any changes or expecting any changes in Google Hotel Finder or its hotel-related search offering and maybe what kind of impact that could have on trivago?

Rolf Schroemgens - *trivago N.V. - CEO*

Yes, sure. So in terms of mix of hotels versus OTAs, in a way, what is important for us that the user finds the best, the ideal hotel at the best rate. And so whether that is coming through a hotel or an OTA in a way for us they are all advertisers and participants in the marketplace. And so the share is more driven by their individual competitiveness and their profitability targets on our marketplace rather than anything else.

So in a way, for us, it doesn't really matter. We think that in the mid-term hotel chains that will invest or that are actively investing into technology will be able to become more competitive in online marketing, but for us it doesn't really matter who is actually winning the auction.

On your second point, the EU decision, so our read of the situation is that the EU is committed to ensure fair competition in various different verticals and in one vertical, they have proven that point and taken the decision already. That decision is not applicable as of today to the other verticals, but we think that the direction of the commission is quite clear. So I guess that is for us neutral to positive because it will put more scrutiny on one of our competitors and ensure that we are treated fairly in the competition with that competitor.

Unidentified Analyst

Great, thank you.

Operator

Heath Terry, Goldman Sachs.

Heath Terry - *Goldman Sachs - Analyst*

Great, thanks. I know you have gotten a lot of questions about the decline in ROAS, but one in particular that I just want to make sure we are understanding the right way, particularly with EBITDA turning negative in Q3. How much of that decline would you say is directly related to a like-for-like increase in the cost of ad units or conversion? We are obviously seeing the other participants in the space, Priceline, Expedia, step up their advertising spend. Is that simply just driving the cost on a per unit basis up and impacting ROAS or is there something else to it?

Rolf Schroemgens - *trivago N.V. - CEO*

No, we see nothing of that actually. So we are seeing -- like when we are looking at the marketing side of things, we don't see the impact besides what we intentionally generate and what we intentionally generate is taking this long-term perspective where we take -- where we exchange short-term revenue against long-term higher value creation and we wouldn't do that if we would not expect a higher value creation in the future, then we lose revenue right now. But that is the only effect on the marketing side and besides that we have the effect on the marketplace side through the LPS score.

So we have these two effects and they basically are making up for the effect that we see now in the third quarter and we have not an indication that there is any other things happening, that there is any other deviation from our plan that we have [stated before].

Heath Terry - *Goldman Sachs - Analyst*

Great, thanks. And then on the supplier side, can you give us a sense of where your efforts are with the hotels themselves, particularly as the hotels continue to push more of the loyalty program rates to their base? Any success in getting access to those rates within the trivago sort and can you give us a sense of what percent of mix the hotel direct part of the business is or at least qualitatively how that's growing?

Rolf Schroemgens - *trivago N.V. - CEO*

So we can't tell you -- we don't disclose numbers about the mix. Generally, the direct part is growing, but we don't disclose any further details on that.

The first part of the question was about loyalty rates. We see high interest of hotel chains to get their loyalty rates on trivago and we also have efforts within trivago to offer these rates on trivago. And that is a big project currently also in our advertiser relations team, but currently we still don't have these rates on trivago.

Heath Terry - *Goldman Sachs - Analyst*

Great, thank you.

Operator

We have no further telephone questions at this time.

Matthias Tillmann - *trivago N.V. - IR*

Okay, thank you. Thank you very much. Rolf, any closing remarks?

Rolf Schroemgens - *trivago N.V. - CEO*

Yes, so many thanks for joining the call. We are very pleased with our second quarter 2017. It's good to see that we maintain our focus and maintain our focus on long-term value generation, continuously reshaping the processes and really setting up the Company for the years to come. We are very aware that there is a long way ahead of us and also that we have a lot to learn, but, on the other hand, we are very thankful that this super young team achieved -- or what this super young team achieved during the last month. Thank you for your participation in the call and see you next quarter.

Operator

Thank you. This does conclude the trivago Q2 earnings 2017 conference call. Thank you for your participation. You may now disconnect.
