THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TRVG.OQ - Q3 2017 Trivago NV Earnings Call

EVENT DATE/TIME: OCTOBER 25, 2017 / 12:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Axel Hefer *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Matthias Tillmann

Rolf Schrömgens *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

CONFERENCE CALL PARTICIPANTS

Brian Thomas Nowak *Morgan Stanley, Research Division - Research Analyst*

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

Heath P. Terry *Goldman Sachs Group Inc., Research Division - MD*

Kevin Campbell Kopelman *Cowen and Company, LLC, Research Division - Director and Senior Research Analyst*

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

Mark Alan May *Citigroup Inc, Research Division - Director and Senior Analyst*

PRESENTATION

Operator

Good day, and welcome to the trivago Q3 Report 2017 Conference Call. Today's conference is being recorded.

And 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

Thank you. Good afternoon, everybody. Welcome to trivago N.V.'s financial result conference call for the third quarter ended September 30, 2017. I'm pleased to be joined on the call today by Rolf Schrömgens, trivago's CEO and Managing Director; and Axel Hefer, our CFO and Managing Director.

The following discussion, including responses to your questions, reflect management's views as of today, October 25, 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 comparison 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 Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Yes. Welcome, everybody. Thanks for joining our Q3 earnings call.

So for the last 3 quarters, I was always able to say that we are very happy because the quarter exceeded our expectations. Looking back on Q3, I can clearly say that we are still happy with the initiatives that we have driven forward, but actually, we are not really happy with the financial outcome, that was not satisfying. This was also actually the reason why we gave you guidance update already earlier this year in beginning of September. Our numbers of -- for Q3 did not end up where we expected them to be when we originally set the guidance earlier this year. So that is also the reason why actually I would like to give you some background around the current situation before we go to the top line financials.

So what was still blurred in the beginning of the quarter because of several initiatives that we were all starting at the same time, it became more clear throughout the quarter. We see strong indication that our large advertisers adjusted their profitability expectations towards us and, therefore, impacted our commercialization. So while we are confident that the value proposition and the growth potential of the company remains unchanged, we see that we simply translate less of the value that we generate into revenue, and this has, of course, a direct impact on our total revenue.

But indirectly, more than that, it also affects our performance channels because we're keeping there the profitability target that we had before constant. So taking this new level of commercialization now for a given, we think that we have to face the fact that even if we keep on our track of constant optimization of our marketing channels, constantly improving the product, it will be still challenging for us to grow again revenues before this impact is looped in Q3 2018.

Although we see and we want to take this as a challenge, we also see the opportunities. So on one side, we believe that our large advertisers are now much more profitable in our traffic, and this should improve our position. It will be more costly for them now to make changes in their bidding strategies on our marketplace. On the other side, we see a more diversified advertiser base that could serve as the foundation for more competition going forward.

Honestly, of course, we would have hoped that this adoption in the advertiser structure would have happened over time through continuously improving the competitiveness of all players on the marketplace. But actually, now that it happened, we have to -- we have sharpened our focus again on even more rigorously working on giving all OTAs, all chains, individual hotels and other players access and a fair chance to compete on the marketplace. And that -- this will be our main focus for the upcoming year.

So let's now take a look at the top line financials. So Q3 revenues grew, mainly due to the negative impact of commercialization, 17% year-on-year to EUR 287.9 million. For the first 9 months, total revenue has grown 46% to EUR 853.8 million. The EBITDA for Q3 came down to minus EUR 7.1 million. But looking at the first 9 months, EBITDA stayed stable, around EUR 15.3 million.

We are continuing our strong growth path in the rest of the world segment that gained, again, an importance. On the side note but I think also specifically important for those markets, we keep on track regarding the transition to mobile. Now more than 60% of our revenues are generated on mobile devices.

Many thanks. So let me now hand over to Axel to give you some more details on the financials.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

So as Rolf has mentioned already, I mean, total revenue development in the third quarter was 17% versus the third quarter 2016, and 46% in the first 9 months compared to previous year. Adjusted EBITDA went from EUR 6.3 million in the third quarter 2016 to minus EUR 7.1 million in the third quarter of this year. And as a result, the net income went down from minus EUR 1.5 million in the third quarter 2016 to minus EUR 7.7 million in the third quarter of this year. Year-to-date, the loss was reduced from EUR 51.5 million loss to EUR 3.5 million loss this year.

If we look at the return on advertisement spend in the third quarter, it came down from 115% in 2016 to 111% this year, whereas in the first 9 months of this year, we reached 115% comparing to 116% in 2016. The adjusted EBITDA margin came down from 2.6% in the third quarter of 2016 to a loss of 2.5% in the third quarter 2017. And the year-to-date numbers compare 2.8% for 2016 to 1.8% in 2017.

Given that some drivers of the business have had an impact on multiple KPIs, I would like to point out the different impacts on our key KPIs upfront before going through the KPIs individually. As Rolf mentioned, we believe that advertisers have changed their profitability targets on our platform compared to the third quarter 2016, and as a consequence, our commercialization has come down. This lower commercialization implies lower bids, which for the same referrals lead to a lower revenue per qualified referral. As it is a direct margin impact, the return on advertisement spend is going down at the same time. And through the lower margin, we are not in the same position to invest into advertisement, and as a consequence, qualified referral growth has come down as well.

Based on our data, our booking conversion on the other hand has improved and so -- for 2 reasons. One is product optimization, and the other reason is the implementation of our new attribution model that we covered in the previous calls. And the impact is slightly different on the different KPIs.

So looking at product optimization. There's more value generated per referral because the booking likelihood is going up, and as a consequence, there's more revenue per qualified referral. This again has a direct impact on profitability and, as a consequence, improves the return on advertisement spend.

The changes through the attribution model leads to higher revenue per qualified referral as the marketing channels are more focused on higher-converting traffic and are bidding more aggressively on that part of the performance marketing channels. The return on advertisement spend in the short term is coming down, as we discussed on -- in the past, as the marketplace needs to adjust them to factor in the higher traffic quality into the bid levels. In the medium term, the -- we expect a higher ROAS through these changes as we have a more optimized marketing spend. On qualified referrals, the higher focus on higher-quality traffic leads to a lower overall number of qualified referrals but at a higher quality.

So if you now turn to the KPIs as such. Globally, our qualified referrals have increased from 179 million in the third quarter 2016 to 214 million this year, which represents a 20% growth, and in the first 9 months of this year, increased from 413 million by 42% to 588 million. The revenue per qualified referral came down from EUR 1.36 to EUR 1.32 in the third quarter, which is a 3% drop, and increased in the first 9 months from EUR 1.40 to EUR 1.43, which represents a 2 percentage point increase. Return on advertising spend came down from 115% to 111% in the third quarter and from 116% to 115% year-to-date.

If you now look at Americas. The growth in qualified referrals was 19% in the third quarter from 46 million to 54 million and 44% in the first 9 months from 112 million to 162 million. The revenue per qualified referral in euros came down from 200 -- from EUR 2.12 to EUR 1.99, impacted by foreign exchange movements, in particular against the U.S. dollar, which represents a 6 percentage point drop. And the year-to-date number went up from EUR 1.99 to EUR 2.01, which is a 1% increase. Return on advertisement spend came down from 112% to 110% in the third quarter and increased from 114% to 115% in the first 9 months.

We now turn to Developed Europe. We can see very clearly the opposite effect of the key drivers that we've mentioned before. Despite the drop in commercialization, the revenue per qualified referral increased from EUR 1.28 to EUR 1.34 or 5% as product improvement and our more targeted marketing has improved conversion. Qualified referrals though have been negatively impacted by our change in attribution and grew from 89 million to 90 million or 1%. The return on advertisement spend has stayed flat at 129% in the third quarter and showed a slight decline from 131% to 130% year-to-date.

In rest of the world, the qualified referrals grew 56% from 45 million to 70 million in the third quarter and 87% in the first 9 months from 96 million to 180 million. Revenue per qualified referral went from EUR 0.76 to EUR 0.79 in the third quarter and from EUR 0.83 to EUR 0.90 in the first 9 months. Return on advertisement spend showed a slight decline from 88% in 2016 to 87% in the third quarter 2017 and in the first 9 months increased from 88% to 91%.

Looking at our guidance for 2017. We expect our results in the fourth quarter to be negatively impacted by changes in bidding strategies by our advertisers that could have a longer-term negative impact on us. On the other hand, we have seen a reduced commercialization, but, on the other hand, a reduced dependency on our 2 largest advertiser groups. As a result, we reduced our annual revenue growth guidance to 36% to 39% annual growth while we continue to expect a positive adjusted EBITDA for the year. Looking to next year, we assume that these impacts will make it challenging for us to grow in the first 6 months of 2018, and we expect to return to a positive growth trajectory in the second half of 2018.

Matthias Tillmann

Thank you, Axel. Allison, we would now like to take the questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll now take our first question from the line of Douglas Anmuth from JPMorgan.

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

Wanted to ask you 2. Just first, you talked about your largest advertisers changing their profitability targets. Just curious if you could give us some more insight on why you think that's happening. Is it because of relevance assessment or something else? Or is it just more in terms of their own strategy and how they're marketing? And then second, you talked in a couple of places just about obviously lowering the concentration from large advertisers and creating opportunity for other marketers. How do you actually level the playing field going forward and get hotels direct and perhaps some other OTAs onboard more?

Rolf Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

So let me first say, for us, it's super, super hard to comment on the strategies of our advertisers, right? So what we see on our side is the outcome, but of course, we don't see the reasoning behind that. That can have different reasons. I think what we've seen in the past, that there has been always volatility. I think there has been always different strategies throughout the years. Sometimes it's also driven by other channels. It's also driven by that they want to be more profitable, that they may be also compensating for profitability -- or not-so-profitable traffic that they had before. So -- and there's a lot of different reasons why they could do that. There's some reasons maybe that might be more strategically that would have longer impact, but there could be also more short-term impact. So right now, we would just take this new commercialization level as a given and build growth upon that. So second question was -- and I think that is closely connected because I think it depends on like how much are we able then in the future to support all other advertisers which are not part of the 2 large advertiser groups, how we -- how do we support them to be so competitive that they are driving the overall revenue generation and not only the value generation for trivago. And I think the initiatives that we have outlined in the past, they are still super valid. So I think what you have seen is we have seen a lack in technology so -- which we are addressing with Express Booking. And we have seen very good results with those chains we're working with, and those OTAs that we are working with, we have seen very good results. But there is still a pipeline of implementation ahead of us, and we will even work harder to get this pipeline done faster. It's not always up to us because we work with also, sometimes, more traditional companies that take a longer time, but that's something that we are providing them, the technology that is competitive with the large advertisers. On the other side, I think we have to make sure that all advertisers have the same information and ability to compete on the marketplace. And I think that is something where we can also do better. I think we have shown in the past that we have seen strong adoption rates from our Automated Bidding. But that is still something that can be rolled out even further, and for us, it's also not stopping with Automated Bidding. So we are currently also thinking about ways of going even beyond that. I think maybe Axel wants to add something.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

I think the -- it is important to continue on the initiatives that we started in the past. And it is very important to -- as we've done in the past, to continue to broaden the universe of advertisers step by step, and every incremental step is overall improving the marketplace. And that is across geographies, it's across [kind] of advertisers, across different kinds of accommodation. And I think there is no fundamental change in our view there. It is more a continuous improvement that we are working very hard on.

Operator

The next question comes from Brian Nowak from Morgan Stanley.

Brian Thomas Nowak - *Morgan Stanley, Research Division - Research Analyst*

I had 2. Just to talk a little bit about the first half of '18 potential revenue declines, can you help at all in kind of even a high-level quantification, kind of order of magnitude you're talking about? And then how should we think about breaking down those declines between revenue per qualified referral from your advertiser adjustments and then referral deceleration from your attribution model changes? And then the second one, I know you called out a second -- a couple of times in the conference, the transcript, about diminishing marginal returns on advertising in the Americas and Europe. Could you just talk about how you work through those diminishing marginal returns you had to start spending on new channels? How do you fix that?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Okay. So let me start with the first question. On the first half of 2015 -- I mean, we are not in a position yet to give specific guidance there because we have not passed our budgets for 2018, but we will do that once we are in a position to give more specific guidance. On the impact on the revenue per qualified referral and the qualified referral impact, I mean, as you can see already in the Q3 numbers, the main impact that you see and change is really the qualified referral growth trajectory because we have compensated through the various initiatives that we've been working on for quite some time the drop in commercialization. And so I think that's the -- that is something that we will aspire to continue to do, and that's, at this point in time, as much as I can say about next year.

Rolf Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

The second question on diminishing returns on advertising?

Yes. Regarding diminishing returns, so I think there is partial evidence for that, but I think we would not go further right now actually. So taking the current creative strategy as a given, which is not a given but constantly developing, we've seen those diminishing returns in the summer months in some of our markets. But also, the spend level in the summer months is -- or was, in some of these markets, extremely high, so -- and there is the time when you reach this point with the current setup in a specific month. That's possible. That doesn't mean that there is no growth potential of that spend in the future. So -- and I think there are also -- several things came together also that made us do those remarks, which is also the effect of commercialization that became, over the quarter, also more visible for us, that this had been effect that we maybe underestimated before. So I would be careful with these diminishing returns. I would say there is evidence in peak months in the large markets with the current creative setup. With the new creative setup, I would not say that this is -- would be ultimately the case.

Operator

The next question comes from Mark May from Citigroup.

Mark Alan May - *Citigroup Inc, Research Division - Director and Senior Analyst*

I also had 2 questions. First, another clarifying question around the first half '18 commentary. I think your language is around challenging growth. Should that be interpreted as -- because I think a lot of people are interpreting that as negative growth likely in the first half of the year. Or are you messaging that growth will continue to be challenged, similar to the low to mid-single-digit growth that you're guiding to in Q4? And second question is, do you think that the changes in the bidding strategies by some of your advertisers is specific to trivago? Or are these likely broader changes that these advertisers are making across some of their other meta-search and performance channels? Just trying to understand how company-specific these may be to trivago.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

On the question on 2018, so what we mean by our guidance comment is that it will be challenging to show positive growth. And so in a way, as I said, we can't quantify that yet. But -- so in a way, we would interpret that as 0 or potentially lower. But the more specific guidance, we will provide once we've passed our budget.

Rolf Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Regarding your second question, I think that's hard to say for us. I mean, right now, there is no -- I think there is no indication that we've seen. So for us, it's hard -- it's really hard to tell. If that's a general strategy shift, if it's a reaction -- if it's a general reaction that is impacting all meta-searches, if it's a reaction that is only impacting us, it's really, really hard to judge right now.

Operator

The next question comes from Heath Terry from Goldman Sachs.

Heath P. Terry - *Goldman Sachs Group Inc., Research Division - MD*

Just a couple of questions on -- and realize that your visibility into some of this is limited, but would certainly appreciate any insight that you have. To what extent do you think the changes in strategy that you're seeing are related to the changes that we've seen in either conversion rates or commissions being paid by hotels because of the -- either because of hotel direct programs or simply renegotiations in contracts that we've seen over the past year? So to the extent that they're seeing lower price per lead or lower price per customer, is that simply being reflected back through trivago? And then to the extent that hotel direct is becoming a bigger priority for the suppliers themselves, any plans on your part to accelerate the technologies that you've been developing to accommodate direct supplier relationships?

Rolf Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Let me just check. So the first question was -- just have to go back to the first question.

Heath P. Terry - *Goldman Sachs Group Inc., Research Division - MD*

First question was just simply are you -- is the change in profitability per customer at the OTAs simply being reflected back through to their bidding strategies? Or is there something else?

Rolf Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Okay. So I think the indication that we have is basically that we get less for the value that we generate. So -- and that is an indication that we have, and I would think we are quite clear about that. Still, like what expectation they have, like -- or what they get, of course, through their margin development or what kind of changes are implied through margin development, that is something that's really hard for us to say. I can just like -- I think if you're looking like at the Expedia numbers, I think, that they showed, they had a margin decrease. But that happened basically rather in the previous period, and it's not affecting it right now anymore, right? So there, you would get an indication basically which says like there's no indication right now that there is a significant margin decrease on the OTA side.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

On the question on the acceleration of the technology to help advertisers, so I mean, I -- we've discussed it before. We have been very focused on providing tools to our advertisers to level the playing field, and we continue to believe that it is a very, very important part of our overall strategy. The pace of the technology development is not necessarily the critical part. It's more of the time to implement the education and then, in a way, the onboarding. And that, for sure, is a big focus of ours, has been in the past and is for the future.

Rolf Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

And we also see very big interest. So sometimes there is like it's struggling in the implementation but it's not struggling in the really understanding, we're not struggling in the spending of large players in this market that they say, "No, actually, this is the way how we want to advertise, how we want to push into the market in the future." So I think there is a clear understanding and a big alignment. Sometimes there's just like we struggle in the technical implementation because I think there, always 2 companies have to work together. And that is something where we have to be faster, develop better processes, and that's what we definitely will focus on.

Operator

The next question comes from Lloyd Walmsley from Deutsche Bank.

The next question comes from Kevin Kopelman from Cowen Group.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - Director and Senior Research Analyst*

Could you walk us through how you think about returns on your performance ad spend and specifically your high-level approach for attributing revenue or value to the ads that you're buying? And then as a follow-up to that, as we look at Q4 and into 2018, do you expect any change in your ad budget mix of TV versus performance spend compared to where it's been for the last couple of years?

Rolf Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

So currently, we have not changed the levels of profitability, and that's also the reason why growth came down more massively, right, because you have -- like when you're losing extra spend on commercialization, then you're losing a multiple of that on revenue when you keep your growth -- your profitability targets on the same level. And I think that's what we have seen in this regard. And of course, now just looking at our current mix, there is a tendency towards more brand because the growth is in the performance channels that have been there before, and the year-on-year growth is not there anymore. So I think when we compare it year-on-year, there is a tendency towards brand. Like how that will be in the future, I think that is something that we have not done yet because that's the budgeting question for the next year. And I think there is also some decisions to take for us. Like how aggressive do we want to be there? Do we want to be maybe more aggressive in the performance channels? Do we want to keep the current level? And I think that are decisions that we're taking right now for the next year, and depending on that, the mix will change.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

On your question on the attribution in the performance marketing channels, so the attribution model has changed, and we are currently rolling that out. So basically, in the new model, we are focusing very much on the ultimate booking and so in a way, on the quality of the specific campaign and attribute value based on the quality across the different campaigns, whereas in the old model, which we are step-by-step substituting, there was a greater weight on the immediate click out and so on the immediate direct measured revenue.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - Director and Senior Research Analyst*

Okay. Axel and Rolf, that's really helpful. And if I could ask one other question. You talked about the greater diversity in the advertiser mix. I think in the past, you had -- it was about 80% to the 2 large advertisers. Can you give us any initial sense of what you're seeing for the fourth quarter in terms of that number changing?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

So we -- obviously, it's early days in the fourth quarter, and it is -- it's only, at this point in time, an estimate. But we see a tendency of the 2 larger advertiser groups reducing share in the overall business.

Operator

(Operator Instructions) And we will now take a question from Lloyd Walmsley from Deutsche Bank.

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

Can you guys talk about just what you're seeing over the course of the quarter and into October in terms of bidding activity? Are you continuing to see declines? Are you seeing some bottoming? You guys have talked about improving conversion. So has that resulted in any improvement in the pricing trajectory? Apologies if you already covered this.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

So we've seen -- as I indicated through the change in the mix, so far in this quarter, a continuation of the trend in the third quarter. And I don't know...

Rolf Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Yes. I think for the fourth quarter -- so what we've seen now is that there is a base in the structure that we've seen. So there is -- you can see that in the first slide that I've shown. And that is now constant for a couple of weeks, so that is quite constant for a couple of weeks. So that is a good indication, it's a good indication that it's now the solid kind of state. But that's always taken with a grain of salt, and let's see what the future brings.

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

And I guess another, if I can. Can you just talk about what your conversations qualitatively are like with big advertisers and how they're reacting to the new landing pages and just generally what their feedback has been on the platform and -- with all the changes that have been going on?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

We continue to have an active dialogue, obviously, through our key account managers with all advertisers. And on that, there is nothing specific about the content of these discussions that we would be willing to share.

Operator

(Operator Instructions) As there are no further questions in the queue, that will conclude today's Q&A session. I'd now like to turn the call back to our host for any additional or closing remarks.

Matthias Tillmann

Thanks. Rolf, any closing remarks?

Rolf Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Yes. First of all, thanks for joining the call. So yes, we would have hoped for better results in this quarter, but our confidence in the long-term value proposition of the company is unchanged. We see that our way of incremental progress and every single process is still delivering constant improvements in marketing the product. We see how we grow the user value that we create, and we believe in the potential that lies ahead of us. We think that with a more diversified advertising structure, we will now have a solid basis that might also then in the future be a driver for growth.

So thanks again for joining, and have a great day.

Operator

Ladies and gentlemen, this concludes today's call. Thank you very much for your participation. You may now disconnect.