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TRVG.OQ - Q3 2018 Trivago NV Earnings Call

EVENT DATE/TIME: OCTOBER 24, 2018 / 12:00PM GMT





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## PRESENTATION

**Operator**

Good day, and welcome to the trivago Third Quarter Earnings 2018 Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Elie Matta, Head of Investor Relations (sic) [Head of Corporate Development]. Please go ahead.

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**Elie Matta** - *trivago N.V. - Head of Strategy and Investor Relations*

Thank you. Good afternoon, everybody. Welcome to trivago N.V.'s financial results conference call for the third quarter ended September 30, 2018. 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, reflects management's views as of today, October 24, 2018, 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 2017.

With that, let me turn the call over to Rolf.

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

Welcome, everybody. Many thanks for joining our Q3 earnings call 2018.

Let's be honest that 4 -- last 4 quarters and the last 4 quarters' earnings calls have been quite a challenge. Just to remind you, in Q3 2017, we experienced a drop in our commercialization as our core advertisers adapted their performance targets. We received significantly less for every euro booking volume that we generated for them. As this directly affected our bottom line, we were accepting losses for the first half of this year that summed up to nearly EUR 40 million. Still, we were not able to keep up the growth trajectory compared to the very strong quarters that we had the years before.

In Q2 this year, we concluded that the magnitude of these losses was not in line with our culture anymore. We built this company with very little external funding and remained close to positive EBITDA through all these years. We were always maximizing our growth potential, yes, but we also aimed not to be dependent on external funding. This led to our decision to raise our marketing profitability targets during Q2.

Our aim was to rebalance the business on a higher profitability level and start growing again after that. Clearly, I have to thank the team for following us like they did through these, at least for us, new challenges. It was not always easy, but we also learned a lot.

The more I'm happy right now to say that the last quarter exceeded our expectation. The positive signs that we carefully talked about in the last earnings call turned into strong signals. But this time, we'll not leave it to strong signals alone. This quarter also showed promising results.

As a direct consequence of our significantly raised marketing targets and our decreased ad spend, our revenue ended up at EUR 253.7 million for the quarter or down 12% year-on-year. This was mostly driven by a decline in qualified referrals, which reached 189.1 million in Q3, also down about 12% year-on-year. Our revenue per qualified referral stayed stable on a year-on-year comparison at the level of EUR 1.32.

Please keep in mind the trends in qualified referrals and revenue per qualified referral are still influenced by our continuing effort to focus on high-quality traffic on one side and the lower commercialization levels on the other side. Referral revenue by segment saw continuing increasing share of the rest of the world market as well as a small shift from Americas towards Developed Europe.

Now let's have a deeper look into the results of the rebalancing of our excess advertising spend that we started in the second quarter of this year. While we were still growing our ad spend in the first quarter, we now have adjusted our targets across all channels to reflect the changes in commercialization. By doing this, we reduced ad spend significantly by 28% in a year-on-year comparison to EUR 184.3 million. These measures have led to a significant improvement of ROAS, return on advertising spend, overall. The 136% return on advertising spend in Q3 is representing a 25 percentage point improvement compared to Q3 2017.

Looking at the resulting total profitability, our first quarter still had seen a year-on-year EBITDA decline of EUR 41 million. We were able to reduce that decline to EUR 21 million in the second quarter. In the third quarter, we turned this trend around and now see a EUR 34 million increase compared to the previous year.

Despite the not very favorable changes in the market environment that we have seen in the last years, we are now able to announce a record quarter with EUR 26.6 million in EBITDA. This healthy profitability gives us the confidence to keep on focusing on the business and delivering the best possible experience for our users.

Over the last 2 years, we have focused a lot on reshaping our major technology platforms to allow us a steeper learning curve in the future. We think we are now in a place where we can reaccelerate our product development and innovation. One of the examples which we are especially proud of is our new app, which we very recently launched both on iOS and Android. These new apps are not only built on a new software infrastructure but also come with completely redesigned user interfaces and improved functionality. Although launched -- just launched, we see that users stay significantly longer in our app and are consuming more content.

Another topic which we have continuously kept you updated on is our ongoing effort to onboard alternative accommodation providers. While we are very excited about the opportunity, we are also approaching the project with a gradual increase. We are carefully scaling the exposure of alternative accommodation within our listings and see patternization of our result as a key leader for it. Still, we are proud to say that we now crossed the 1 million properties milestone, and we will continue on our path of a gradual increase of visibility.

We have been also updating you continuously about our advertiser mix. Traditionally, the advertiser mix varies per quarter due to different seasonalities per market. If you compare the current quarter with Q3 2017, you can see an overall stable development. Still, on the margin, booking holdings gained share in Americas, Expedia gained share in Developed Europe, and all other advertisers did very well in the rest of the world market.

So now I'll hand over to Axel to discuss financial performance.

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

So the revenue in the third quarter reached EUR 253.7 million coming from EUR 287.9 million in the third quarter of 2017, which represents a 12% drop year-over-year. In the year-to-date numbers, we are, for 2018, at EUR 748 million compared to EUR 853.8 million in 2017, which represents a 12% drop year-over-year.

Looking at the adjusted EBITDA, the minus EUR 7.1 million in the third quarter 2017 turned into EUR 26.6 million in 2018, which represents a 10.5% adjusted EBITDA margin as a percent of total revenue. For the year-to-date, the adjusted EBITDA reached minus EUR 13 million, which represents a minus 1.7% adjusted EBITDA margin as a percent of total revenue.

Coming to the net income. We have reached a net income of EUR 10.1 million in the third quarter 2018, up from a EUR 7.7 million loss in the third quarter 2017, which represents, this year, a 4% net income margin as a percent of total revenue, up from minus 2.7% net income margin as a percent of total revenue.

Looking at return on advertisement spend. We saw a 25 basis points (sic) [25 percentage points] increase from 111 percentage points in 2017 in the third quarter to 136% in the third quarter 2018. For the year-to-date, we saw an increase of 2 percentage points, up from 115% in 2017 to 117% in 2018.

Looking at our global KPIs. We saw a decrease in qualified referrals of 12%, down from 214.2 million to 189.1 million in the third quarter; and a 5% drop year-to-date, down from 587.8 million to 555.6 million. The main drivers of this development were the increased marketing and profitability targets that Rolf mentioned earlier and the impact of the attribution model and the product optimizations.

If we look at the RPQRs on a global level, we see in the third quarter a flat development at EUR 1.32, whereas the year-to-date number reached EUR 133 (sic) [EUR 1.33] compared to EUR 143 (sic) [EUR 1.43] in the same period 2017. The main drivers influencing the RPQR were the drop in commercialization that Rolf mentioned earlier; the impact of the attribution model and the product optimizations; and also, to a lesser extent, foreign currency effects in our Americas and in our rest of the world segment.

Return on advertisement spend went up 25 percentage points in the quarter. The main driver of that is obviously the increased marketing profitability targets and optimizations behind that, on the positive side; on the negative side, the impact of the drop in commercialization.

Coming to our Developed Europe segment. The qualified referrals dropped 16% in the third quarter, down from 90.1 million to 75.8 million. And year-to-date, the qualified referrals dropped by 15%, down from 245.8 million to 209.4 million.

The RPQR was up 13 percentage points in the third quarter from EUR 1.34 to EUR 1.51; and year-to-date, up 3% from EUR 1.44 to EUR 1.49. The main driver of these 2 metrics has been the significant improvement in traffic quality that impacted both the QRs and the RPQRs compared to the other segments. ROAS went up 21 basis points (sic) [21 percentage points] in Developed Europe from 129% to 150% in the third quarter and 5 percentage points year-to-date from 130% to 135% for the year-to-date.

In Americas, the qualified referrals dropped 19% from 54.3 million in Q3 to 44.1 million in Q3 and year-to-date by 7% from 161.8 million to 151 million. The RPQR in euros came down from EUR 1.99 to EUR 1.83 in Q3 and from EUR 2.01 to EUR 1.74 year-to-date, which represents a 13% drop. Key drivers in Americas have been the lower commercialization having a negative impact on the RPQR; unfavorable foreign currency effects, in particular on the Latin American currencies; a shift towards lower RPQR locales, compensated partially by a slight improvement in traffic quality. The return on advertisement spend went up 26 percentage points in Q3 from 110% to 136%; and year-to-date, flat at 115%.

In rest of the World, our qualified referrals were more or less flat at 69.7 million in 2017 in the third quarter to 69.1 million in the same period 2018; year-to-date, up by 8% from 180.3 million to 195.3 million. The RPQR in euros went up by 1% from EUR 0.79 to EUR 0.80; and in year-to-date, from EUR 0.90 to EUR 0.84, 7% down.

Key drivers in rest of the world, the lower commercialization, slight negative FX effect and improved traffic quality compensating for that, leading overall to a slight increase in RPQR. On ROAS, we saw a 27% increase from 87% in Q3 '17 to 114% in Q3 '18; and in year-to-date, 91% in '17 to 95% in '18. That's a 4% increase.

Coming to our guidance for 2018. Based on the results of the rebalancing of our advertising, we're increasing our guidance and now expect adjusted EBITDA to be 0 to minus EUR 10 million for 2018. Revenues will be down year-over-year. The key financial metrics are expected to trend in line with Q3 and Q4, with the exception of the following. We expect QR growth to shift towards RPQR given recent product changes, and OpEx and headcount are expected to be flat to slightly down year-over-year.

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**Elie Matta** - *trivago N.V. - Head of Strategy and Investor Relations*

And with that, we hand over back to the operator so we can take questions.

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## QUESTIONS AND ANSWERS

**Operator**

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

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

I wanted to ask 2. So first, you talked about improving traffic quality and getting back on track as you return to EBITDA profit, but what does the future look like here? Is there a way that you can transform the business to be less dependent on those 2 large partners? Or will your strategy be largely based on their views of growth going forward? And then second, in terms of those large partners, you indicated that the ROI targets are higher now than a year ago. But if they continue to ramp those ROI targets through the course of '18, meaning have they gotten even higher on a sequential basis as well?

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

Okay. So on your first question, will we continue to depend on our 2 largest partners, I think, for the foreseeable future, yes, we will. And we talked about that on some of the past calls. We are obviously doing various things to, overall, decrease our dependency on our largest advertisers, but in the short to midterm, we will continue to depend on them.

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

I think, in general, what you have to conclude when you're looking at the overall trend is that we see a stabilization of commercialization in the last month. So it's true that some of the trends -- and we've spoken about it in the previous calls, I think in Q2. We have seen some of the trends continuing into the first quarter of this year, but we have also seen a quite stable development since then. And that is pretty much also in line with the change of strategy that we have seen from our large advertiser side.

So if you're looking at the -- their strategy, I think there's always like 2 different strategies, right? One strategy is maximizing for growth, and then you're saying, "Okay, I reinvest basically everything that I earn into growth." The other strategy is to maximize profitability. And -- but then you maximize profitability and then you found a stable ground, where it's basically not very smart to go even lower with your bids. And what we see right now is that we think our advertisers are way closer to that point where they have shifted from -- completely from a growth strategy to a maximizing profitability strategy. So -- and I think that -- the result of that is what we've seen in the last months. So I think that -- yes, I think Axel's right. I mean there is still a dependency. I think we are trying to minimize it. We see also that our small- and medium-sized advertisers are gaining share, but there will remain a dependency. But we are still in a way more stable status right now.

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**Operator**

We will now take our next question from Kevin Kopelman of Cowen and Company.

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

Just to start, just a follow-up on your previous comments, Rolf. If you think about your own strategy in the same kind of context between maximizing growth versus maximizing profitability, where do you feel like you are? And what's your thought process on where you want to set your ROAS targets on paid traffic? And then I have a couple of other ones.

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

Yes. I think we follow the market, of course, in this kind of strategy, right? So I think we've seen this from our advertisers, and we have also seen that it's super difficult to keep on with a growth strategy against that. So -- and I think that is also the conclusion we came to, that we have to focus more on profitability. Looking forward, I think what we said is that we want to remain at a healthy margin of profitability, so it's not all about profitability maximization. We want to have a healthy margin of profitability, and we think that we can then start growing upon that from there.

And I think this healthy margin for us is extremely important because I think it really gives the organization the confidence. And I think that was something that was also missing when you're looking at our first 2 quarters this year, and it gives us also the strategic independence to take decision and -- that might have a short-term impact but a long-term positive gain. And we've seen that already even in this quarter, us doing that, and that is what we want to achieve. We want to be strategically independent. We want to have a healthy margin, and then we also want to start growing upon that.

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

Great. And so a follow-up on that, can you talk about what you're seeing so far for the fourth quarter along the lines of revenue and ad spend growth? It looks like the EBITDA forecast should be down Q-over-Q, so if you could walk us through near-term comps. And then how -- do you have any initial thoughts on how you're planning for 2019?

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

Yes. So for the fourth quarter 2018, I mean, in general, as I said on the guidance, we expect the trend of Q3 to continue. The fourth quarter is slightly different to the third quarter in terms of spend structure, so that is something worth considering when modeling that comment. On 2019, we will not comment on yet. But we are confident that what we've done in the third quarter, that is the right track to continue on. And we would expect that to have a positive impact in the first half of '19 as well.

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

Okay, great. And then just a couple of questions on some of the newer initiatives. Can you give us more color on the vacation rental work that you're doing and how the uptake has been from trivago shoppers so far?

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

Let me do that. So I think we've shown the slide which shows you that we onboard more and more inventory, and that is basically one work stream where we continuously put more inventory on a level that we can show to all users. It does not always mean that we ramp up the visibility in the same manner. So what we tried to do is we tried to increase visibility gradually. And one effort that we are taking there is that we try to personalize more so that we really can show those users who are rather -- the alternative accommodation bookers more inventory like this; and the others, rather less inventory.

We think that is one strategy, how you can make that work for an integrated search. We want to have an integrated search. We don't want to like show kind of different tabs, have different entries into the product like other competitors do that. We really want to -- we see these leads as substitutable. We want also turn alternative accommodation users maybe into hotel users, hotel users into alternative accommodation users. And we think we have the right product to do so. So we see a fully integrated approach, but this integrated approach also means that we have to increase gradually and it will not just be one push.

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

Just to add to what Rolf said. I mean, in the last year, where we put significantly more focus on it, we have seen also on our side and through the usage of our users that there is a need for an integrated product and there is demand. So there is an increasing user base that is crossing over from one category to the other quite dynamically. And so that gives us confidence that we are on the right track.

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

Is that something that you -- that kind of cookie data can help you with as you see this person has been searching for vacation rentals on other sites and things like that?

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

Yes, but it's not only cookie data. Actually, it's quite interesting, like you reveal a lot of your preferences when you're looking for a destination, right? So when you're looking for a specific destination, that gives you already quite an insight, the dates that you're looking for, how many days in advance are you looking, are you searching for a single room or are you searching for 2 double rooms? So that is -- those are all things that significantly change the probability to be an alternative accommodation user. And I only state the obvious ones, so there are many more criteria. So yes, we get a better picture after you send your search request.

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

Great. And if -- I know I had a lot of questions, just one last one. Can you talk about your efforts to drive engagement and spend from the major hotel chains? And any progress you can share there?

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

Yes. We never commented on the share of individual advertisers other than the 2 large groups. So we don't comment on that.

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**Operator**

We will now take our next question from Brian Nowak of Morgan Stanley.

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**Alaxandar Wang** - *Morgan Stanley, Research Division - Associate*

It's Alex Wang on for Brian. Just 2. First, how are you thinking about the drivers of revenue growth into 2019? What are the maybe 2 or 3 KPIs that you think are important to execute on to reaccelerate revenue growth? And then second, just following up on Rolf's earlier comment around the top line versus profitability. Maybe perhaps you can expand a bit on if there's been any philosophical change in how trivago is thinking about top line versus profitability. And if there's -- if so, is there any new way we should think about the long-term profitability of the business, particularly relative to the 25% margin, I think, you've communicated in the past?

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

Yes. I think your first question was about what kind of key growth drivers we see for the next year. And I think when you're going into the different pillars of trivago, you can go through the different key drivers. I think what we see is that during the last year, we were really able to improve efficiencies of our marketing spend quite significantly, and that was a driver of productivity at least in the past, and that's also the reason why we were able also to raise profitability so much in the third quarter. So we have seen this efficiency coming along, and we see that we are still in the trajectory that we can improve efficiencies in our advertising spend in the next year.

Looking at product, I talked about that during my presentation. I think that we really heavily invested into building up platforms where we can have a new growth trajectory. And we have one example where we really like, have now the chance to iterate way faster than we have been in the past. This was an investment that we were taking regarding the app specifically in the last year, where the improvement -- the continuous improvement of the app was basically stopped for let's -- I think, nearly like 9 months, and now we're iterating again and improving continuously.

We had to do this because when you are on an old technology platform, the incremental gain that you have gets smaller and smaller. So there is one day when we have to decide to go back and then go to a new platform and then learning from there. And actually, a very similar thing is true for our whole back-end infrastructure that we've revamped and that we are about to launch right now so -- for our desktop and mobile website. So these were investments, we think, that there is more opportunity in the future to improve the product than we had in the past.

And then going to advertiser relations, I think -- we believe that there is a way to also increase the efficiency of small and medium advertisers and drive more competition in the marketplace. And that is definitely like a key focus, again, next year to do that. And of course, I mean, we still have -- we still see the largest growth opportunity when you're looking at the overall market. You see that in the rest of the world market, where there is a lot of markets where we can -- where we see that we are just in the beginning of our growth curve. So -- and in general, I mean, this market is really so huge. Our share is quite small, and the clear idea is to gain share over time.

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

To come to your second question, how to think about the trade-off between top line development and profitability. I mean, let me start with the end of your question, have we changed our view on our long-term profitability target. We have not. And so the 25%-plus adjusted EBITDA margin that we talked about at the time of the IPO, we still believe is the right number. What we have changed, obviously, as you have seen in this quarter, is the balance between top line push and profitability. And there, we really reacted to the developments in the market. And I guess what you're really asking is, okay, how should we think about that trade-off going forward. I mean, there has to be the right trade-off of really the overall growth and then the profitability increase. We believe that overall absolute profit should go up, and I guess, there will be a dynamic reassessment how profitable and how elastic additional spend in top line development will be from that base that Rolf mentioned earlier. And I think that will change -- will change the market dynamics and over time. But overall, we want to increase our profitability over time in absolute terms. And on the relative terms, I think we will adapt to the market situation as it develops.

**Operator**

We will now take our next question from Naved Khan of SunTrust.

**Naved Ahmad Khan** - *SunTrust Robinson Humphrey, Inc., Research Division - Analyst*

Two quick ones for me. Maybe, Rolf, you can maybe give us some more color on the changes by your large advertisers. Are both of them making the changes? Or is it just one of them? And I'm saying that because I see that one of them actually increased share and the other one lost share. And then I had a quick follow-up.

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

Yes. I mean, the changes that we are speaking about are overt changes mainly in the third quarter of last year, and we are still kind of like seeing, of course, the results right now of that. But then speaking about the most recent changes in the share development, yes, I think what you -- what's underlying -- you're seeing the global trends are quite stable on a year-on-year comparison. But what you see is that, in total, there is a very slight increase, I think, of Booking.com and slight decrease of Expedia and a slight increase of other advertisers.

But underlying that, there are very different developments in the different segments. And what we can say is that Expedia is, in general, gaining more share in Developed Europe and Booking.com is gaining more share in America. And we were able -- and that is one of the things where we have been really successful in like ramping up the -- of the advertisers in the rest of the world market, where we still see also a more fragmented structure of advertisers. When you're looking at the Indian market, huge market, very fragmented structure of advertisers. So -- and there we were able to grow the rest of -- the other advertisers more strongly.

**Naved Ahmad Khan** - *SunTrust Robinson Humphrey, Inc., Research Division - Analyst*

Okay, that's fair and that's very helpful. And then the follow-up question I had was about your advertising mix. So as you reduce your own spending on TV and other brand channels as well as in performance channels, how is the mix looking? Is it kind of pretty much even direction across both performance and brand? Or are you cutting back more on one versus the other?

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

No, no, we very consistently increased our target. And we're looking at all channels pretty much in the same way and looking for pockets where we see inefficient spend. That happens in performance marketing as well as in brand marketing, but it's very consistent, very consistent across the channels.

**Operator**

We will now take our next question from Lloyd Walmsley of Deutsche Bank.

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

Two, if I can. First, just the guidance at the high end implies, I think, about EUR 13 million in EBITDA in 4Q, which is traditionally, seasonally, the strong quarter. So I was just wondering if there's anything we should think about there in terms of signaling a plan to drive growth, investing in marketing or anything unusual beyond perhaps conservatism to keep in mind.

And then the second question, wondering if you can just give us an update on your performance marketing spend within the Google travel ecosystem and their kind of metasearch product. And then, I guess, just stepping back, this is also clearly a threat. So do you sense that they're moving any more quickly or aggressively within that business in terms of product development or otherwise? Any comments you can share there would be great.

**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 guidance for the fourth quarter. You're right, the fourth quarter is historically our strongest quarter because the advertising spend and particularly, the brand advertising spend is lowest because we are competing, obviously, in most of the markets with the Christmas season where the advertising spend is very expensive. And as a consequence, it's not as economical for us to spend aggressively as in other quarters. So that's the reason why it is historically one of the strongest.

On the other hand, in terms of optimizations, obviously, that has an impact on how much you can optimize on that basis. And I think you need to look at both levers at the same time to basically come up -- or that's how we looked at it to come up with the guidance that we've given. On the second point, performance marketing and there, in particular, Google hotel ads, we said in the last couple of quarters -- I mean, we currently see it as an opportunity.

And why is it an opportunity? Because we are underrepresented globally in that channel because we only have recently started to engage in tests and scale up the tests. So the test and -- perhaps, it's not right to talk any more about tests. So in the markets where we have tested, we are not fully scaled up. But we have reached significant scale already, and we are now scaling up still in those markets also geographically. So we are still benefiting from catch-up if you want to say so.

Strategically, Google has always been one of our competitors with that product, and they have recently made some changes to their product as have we, as Rolf said earlier. And so there, we don't see a significant change in the value proposition pace of them versus us recently. So overall, we still see it as an opportunity by increasing our share in the channel, to reach our fair market share, if you want to say so.

**Operator**

Our next question from James Lee of Mizuho Securities.

**James Lee** - *Mizuho Securities USA LLC, Research Division - MD of Americas Research & Senior Internet Sector Analyst*

Just wanted to dig a little bit deeper into your marketing spend. Any way you can give us some clarity? Which channel are you cutting the most specifically? And maybe help us understand by geography where you're cutting the most. It seems like -- based on QR growth, it seems like U.S. more than other geo. I was wondering if that's right. And lastly, maybe you can give update on your mix of paid traffic. I remember, historically, you said brand, 50%; SCM, 35%. I wonder -- I was wondering if there's any meaningful change to the mix.

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

Yes. As I said before, we have raised our targets consistently over like the different channels, and that is also resulting basically in a consistent reduction of spend. So there, we -- and also, it's actually resulting in a stable share per channel. So that said, you spoke about like on a geographical level, are there differences. And you mentioned U.S., and that's right. We reduced more in the U.S., but that is due to several effects. One of them is that we generally historically have also more commitments in the Developed Europe market than we have in the U.S.

And on the other side, you also have to keep in mind that we -- or I'm telling you that we had like a push last year which was quite significant in the summer months, which was our record spend month last year in the U.S. And that is why we've significantly more reduced in the U.S. than in Europe.

**James Lee** - *Mizuho Securities USA LLC, Research Division - MD of Americas Research & Senior Internet Sector Analyst*

Any update on the mix of paid channel, brand versus SCM?

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

Yes. As I said -- no, the same. We consistently reduced targets, so the mix -- according to that, the mix stays the same.

**James Lee** - *Mizuho Securities USA LLC, Research Division - MD of Americas Research & Senior Internet Sector Analyst*

Okay. And one more follow-up question on your largest advertising partners here. It looks like Booking.com, obviously someone asked that question, ramping up this quarter. Is that more of the seasonality? Or is there anything kind of above and beyond that indicating they are ramping up in terms of volume? But I assume they're still bidding down at this point. And also, during the high season, just curious to see Expedia actually pull back. And any specific reason why you're seeing them pulling back? I assume they're pulling back in the U.S., and just curious what is the dynamic there with that advertiser.

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

Yes. I mean, given that the numbers are global numbers, you have to be a bit careful not to read too much into them. I mean, there are 2 things that you need to consider, and I guess, you don't have enough years to clearly see that trend. There is -- there's clearly a geographic mix effect, so the market share of our large advertisers is not the same in the different regions. That's one effect. There is change between the regions. The other effect is that there's also a seasonality effect that is not identical for every advertiser that you need to consider, and you can slightly see it in the global numbers.

And the trend is also not consistent. As Rolf said earlier, Expedia gained share in Developed Europe, Booking gained share in Americas and the other advertisers gained share in the rest of the world. And the outcome of all these changes is that then what you see in the presentation. So it's not the right conclusion to assume that there is a trend that goes across all the markets and is consistent. There is a lot of mix effect in there.

**Operator**

We will now take our next question from Mark May of Citi.

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

Just a question getting -- it's kind of getting at the relationship between your marketing spend and qualified referral growth. How -- as you continue to rationalize your marketing spend, how should we think about the impact that that has on QR growth, meaning will we continue to -- will we see a pretty immediate and related negative impact on QR growth? Or do you feel like you can kind of maintain a decent level of QR growth despite continuing to rationalize your marketing spend?

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

So if you talk about levels like the year-over-year effects that you've seen in Q3, there, we had significant reduction in our marketing spend and that is -- and that, I mentioned, leading to a negative QR development. So when Rolf said we are rebalancing the business, and from that basis, we will then grow again. I mean, this year-over-year effect you will see or we expect you to see until Q2, which is at a degree that has had obviously a significant impact on QRs.

The second effect that you need to consider, and that's what I said for Q4 and then going forward in terms of changes to the trend in Q3, there is also a negative impact on QR growth with a positive impact on the RPQR development for certain product and marketing changes that can be quite significant. And that is also worth considering. So to see the full picture, it's advisable to really look at all 3 metrics at the same time, QR, RPQR and then ROAS, to really have traffic quality, commercialization, marketing efficiency and fundamental growth altogether and each one of them impacting more than one of the KPIs.

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

Okay. And then, in terms of product and maybe policy changes, what, if any, changes have you guys made or will you -- are you planning to make in terms of the product or even some of your advertising policies towards the advertisers that are sort of resulting in an improvement and in return on investment by your advertisers? Are there a couple of things that you can talk about?

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

Yes. I think when you're looking at the new app release, I think you can get a quite good idea of the direction they're heading. So I really invite you to take a look and also compare it to the experience before, or our current mobile web experience. And what you will see is that we're really investing a lot into improving the value depth of our product. So we're really trying to let people take more decisions on trivago and really let them go deeper into the content, let them really like compare the advertisers more directly than before.

So all of these efforts that we do there -- and I think that is something that you also see happening across mobile web and desktop in the next month. So you can expect us like with the other platforms going into that direction. That will give you a good idea. And I think that is, in general, something that we think that we have to do. We really want to increase the value depth of our product and let people really compare on trivago before they go to the advertiser side.

And we want to give them like an aligned -- a consistent experience throughout the funnel. So we want to make it as easy as possible to go through the funnel to the advertiser, which we think, at the end, is a win-win effect on our side and the advertiser's side. Because you lose or you reduce basically the conflict and the distraction within the funnel. And I think that is something that we -- we're very focused work on in the next quarters, where we already started and that you will see more in the next quarters of that.

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**Operator**

We will now take our next question from Tom White of D. A. Davidson.

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**Thomas Cauthorn White** - *D.A. Davidson & Co., Research Division - Senior VP & Senior Research Analyst*

I'm going to sort of piggyback on the last one. You guys have talked about sort of establishing or trying to establish a healthy margin and then finding ways to grow. Beyond kind of finding pockets of kind of marketing spend efficiency, on the product innovation side, I mean, are there other things beyond kind of these improvements to the app and some of the stuff you just mentioned? Are there new product innovations or new products, maybe it's alternative accommodations that maybe can kind of help drive step-function improvement in your traffic or conversions?

I'm just kind of trying to figure out whether any of those product innovations can kind of be big traffic boosters or conversion rate boosters in a way that could sort of rival your ability to spend money on marketing. And then just on RPQR, it was up in Europe, up slightly in Rest of World but down in Americas. Can you just kind of flesh out the dynamic there so I make sure I understand it?

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

Okay. So I think we've spoken about the strategic topics and where we are heading already a couple of times in the past. And what we did over the last 1 or 2 years is that we not only changed the platform that we built our mobile app on, but we basically changed the whole infrastructure of search to create a search that can work as a learning system, that can continue to learn. And I think that continuous learning is something that will differentiate, in the future, applications from each other.

That said, that is not coming with an initial strong effect. That is effect that will show its effect over time. And -- but I think the big step change from our side is really likely the new infrastructure that we have built. At the same time, we have -- I mean, it's maybe more technical, but we have a completely new database structure. We are now running in the cloud. All those changes, we did basically like in the last 1 or 2 years. And we think that this will allow us to develop further way quicker than we did in the past.

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

So on the RPQR, there are obviously mix effects within all the segments, so it's a bit complicated. But we -- I mean, let me just point out the main differences. So in Developed Europe, we only saw year-over-year a slight decline in the commercialization, whereas in Americas and in rest of the world, we said there was a decline in commercialization. So the trend in Developed Europe is more favorable than in the other regions. That's one very important factor to understand the difference in RPQR development.

The other difference is that there has been a significant improvement in traffic quality through our marketing activities and also product activities in Developed Europe and in rest of the world, whereas, in Americas, it has only been a slight improvement. And then the last point that is more America-specific is there has been a shift from lower -- sorry, excuse me, from higher RPQR regions to lower RPQR regions, namely North America to South America. One driver of that, obviously, has been the difference in advertisement reduction given the different levels of commitment. And I guess those 3 factors you need to keep in mind when understanding the different developments in the 3 regions.

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**Operator**

We will now take our next question from Heath Terry of Goldman Sachs.

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

I did want to follow up on the comment that you made earlier around the increase that you're expecting in revenue per qualified referral because of some of the product changes that you're making. Can you, I guess, flesh that out a little bit more? Are these product changes that are driving higher conversion rates? Are they product changes that are resulting in higher commissions from your partners? Just any additional detail that you can provide there.

And then your commentary in response to one of the last questions around your belief that it's better or the intention to go back to more of the comparison and discovery being performed on trivago, as I recall, that was a big part of the issues that Booking had around this time last year, was that specific flow. Is there something that you've worked out that you believe allows you or will allow you to go in that direction? Or is there some reason that you have to believe that that's sort of no longer an issue for them? Just want to make sure that I'm understanding that specifically.

And then finally, can you update us on your hotel direct relationships, whether or not you're -- you've been able to move any further? Not looking for anything with regard to specific hotels, but just largely, as brands are pushing more -- for more direct loyalty program, generally, loyalty program-driven traffic, whether or not those are prices that you're able to show or whether or not you've seen any progress in building those channels.

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

Okay. Let me start with your first question, so some more specifics around my comment on the guidance for Q4. So looking at the Q3 trends. There, we expect in Q4 to have a more positive RPQR development than in Q3 and a negative impact on the QR that is coming from basically what Rolf was describing before, product changes where we increase the interaction with our own website, which leads to a lower number of referrals and also qualified referrals without decreasing but actually increasing the overall booking value which mathematically reduces QRs and increasing the booking value, obviously, increases the RPQR. And that is just something to keep in mind when building the assumptions for Q4. So it's really a product design-driven impact on our financial metrics that I was referring to.

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

Just to add to that. We also do not expect -- in our plans, we do not expect, again, an increase in commercialization, right? So we expect an increase of traffic quality that we send to our advertisers. So to your second point, it's actually -- yes, it's true that this is something like improving the flow that we have from trivago to our advertisers and seeing trivago and our advertisers more like an integrated system. But that was also one of the ideas behind our LPS core development, which also led to the situation last year.

And -- but I can tell you that I think the discussions that we have today with our advertisers, especially with our large advertisers, are on a different level than we have seen them a year ago. So I think we have found -- we are way more solution-oriented today than we have been 1 year ago, and we think that they are -- and we are way more in a cooperative mode right now, I think, than we have been in the past.

I think from both sides -- like from both our large advertisers, we see a very strong interest to work together with us to really, at the end, optimize the sum of things and not only on one or the other side. And I think that is something that we also see for us -- like a good opportunity for us to develop our product faster forward in the future.

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

To come to your third question on the development of our hotel direct business and there and particularly on loyalty rates visible on the site. I mean, overall, we continue to invest significantly into our relationships and into the support of individual hotel direct and also hotel chains direct. So that definitely stays to be one of our focus areas.

Having said that, it's not something that changes quarter-over-quarter, but it's more a long-term project and a long-term effort. And we are -- we believe that it is the right direction and that it is overall successful. But quarter-over-quarter, there are no significant changes, and you wouldn't expect significant changes quarter-over-quarter.

On loyalty rates, there is no significant change quarter-over-quarter either. It is an interesting topic, and it is not straight -- that straightforward to solve both for the hotel chains and for us as a natural partner of theirs. But it is something that we are working on.

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**Operator**

We will take our next question from Peter Stabler of Wells Fargo Securities.

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**Robert James Coolbrith** - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

This is Rob on the call for Peter. Wondering if you could talk just a little bit more about the environment in Europe specifically in the quarter. Booking had talked about some issues around weather and World Cup. I know you said commercialization was down just a bit year-over-year. But wondering if you could talk maybe about commercialization and conversion development quarter-to-quarter.

Are there any notable changes there and then what you're seeing into Q4? And then also, looking at the internals on the RPQR growth. There were some pretty significant shifts in the quarter in terms of RPQR versus click-out development. Just wondering if you could talk through what was driving the scale of those changes in the quarter.

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

So on your first question, has there been a significant change quarter-over-quarter, I guess year-over-year, quarter-over-quarter, there has. I mean, we said in Q2 for the overall business that there was a double-digit impact on commercialization. But I guess that is more trivago specific than for the overall market because we benefited from the relevance assessment particularly in Q1 and Q2 '17. So in our quarter-over-quarter trend, there is a positive development in Developed Europe. On the World Cup and -- has there been a significant impact of the World Cup on the seasonality, on the overall volume of the market. Given the changes that we started to implement in the second half of the second quarter, for us, that is actually very difficult to see because the main trend that we are obviously seeing is the impact of our spend optimization on our volume. So that's difficult to comment on from our perspective.

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**Robert James Coolbrith** - *Wells Fargo Securities, LLC, Research Division - Associate Analyst*

And anything on the RPR and the click-out rate, the scale of the changes there in the quarter?

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

Yes. On the RPR and the click-out rate, I guess -- I mean, that is a difficult way to look at the business, and that's why we focus all our discussion on the RPQR because the click-out rate is heavily influenced by changes in the product. The QRs are more stable given that they are unique click-outs. And that's why I'm not sure that it is really that meaningful. You can have -- through small product changes, you can have a very significant impact on the RPR and the click-out rates, and the QR is more stable. Having said that, some of the changes obviously have an impact on the QRs as well, and that's what we are talking about earlier. But we would advise everybody to really focus on the QRs because they are much more stable as a metric and as a consequence, much more meaningful than the -- than just the referrals.

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**Operator**

(Operator Instructions) We'll now take the last question from Shyam Patil of Susquehanna.

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**Brendan McGoldrick** - *Susquehanna Financial Group, LLLP, Research Division - Associate*

It's Brendan on for Shyam. Just kind of going back to the RPQR discussion. Just in terms of like the traffic quality improvements sort of driving improving trends in Developed Europe, like how should we kind of think about that beginning to show up in other geographies? And what are some of the puts and takes there? And then just on your growth versus profit commentary, I guess, where do you guys feel you are in terms of -- like you referred to like reestablishing the profit base to return to growth. Sort of how should we think about the timeline for that?

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

So on the RPQR trend in Europe versus the other regions, I mean, it's not that the development in Europe is leading all other regions and you would be able to convert the same trend 1:1 to the other regions. The trends are different, and we have, at the same time, implemented the changes to the product. There are certain pockets where there is a bit of a time lag and particularly, where we have the branded advertising side commitments, which tends to be the case in certain parts of southern Americas and Europe and very few other countries. So there is some time lag there. But it is not that -- Europe has been the first where we implemented certain changes and you could expect to see exactly the same development in the other regions. The development in the regions is slightly different for the reasons that we discussed earlier. On the growth versus the profitability, we believe what we are currently doing is the right thing to find a solid base and then to -- from that base, to start to show solid growth again. So for now, we feel good with what we've done in the third quarter. And I guess once we have lapped that recalibration, we expect to see growth again.

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

Yes. I think from like our like, let's say, midterm goals, we would say, okay, we think right now, actually, we feel very -- like we have a comfortable base or a solid base of profitability. And -- but it will, of course, take a year basically to lap those effects. But it's not going to -- we are right now in the middle of the process, and you can expect the margins even growing now in the next quarters. So I think that is now our new basis where we think that we can start growing on then as soon as we lap the effects.

**Elie Matta** - *trivago N.V. - Head of Strategy and Investor Relations*

Operator, so if we have no more questions, I think we can end the call.

**Operator**

We have no further questions at this time.

**Elie Matta** - *trivago N.V. - Head of Strategy and Investor Relations*

Okay. So we would just like to have some closing remarks from Rolf.

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

Thank you. So we are actually very happy that after some challenging quarters, we are now able to show again significant improvements to compare to the previous year. The new healthy level of profitability, as I said, helps us now to gain confidence in our business model and our organization. And we can go back to focus on producing value for our users and our advertisers. I want to repeat that our clear goal is to rebalance the business on a higher profitability level and start growing again after that.

Thanks a lot, everybody, for joining the call. See you next quarter.

**Operator**

This concludes today's call. Thank you for your participation. You may now disconnect.