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TRVG.OQ - Q3 2022 Trivago NV Earnings Call

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Naved Ahmad Khan *Truist Securities, Inc., Research Division - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen. Thank you for standing by, and welcome to the trivago Q3 Earnings Call 2022. (Operator Instructions) I must advise you the call is being recorded today, Wednesday, the 2nd of November 2022.

We are pleased to be joined on the call today by Axel Hefer, trivago's CEO and Managing Director; and Matthias Tillmann, trivago's CFO and Managing Director.

The following discussion, including responses to your questions, reflects management's views as of today, Wednesday, November 2, 2022, only. trivago does 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 the Q3 2022 operating and financial review and the company's other filings with the SEC for information about factors which could cause trivago's 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 trivago's operating and financial review which is posted on the company's IR website at ir.trivago.com. You are encouraged to periodically visit trivago's investor relations site for important content.

Finally, unless otherwise stated, all comparisons on this call will be against results for the comparable period of 2021.

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

Axel Hefer - *trivago N.V. - MD of Legal, Marketplace, People & Culture and Technology, CEO and Management Board Member*

Thank you, everyone, for joining us for our Q3 '22 earnings call today.

Looking back at the third quarter. We have experienced a very strong summer. COVID restrictions have been lifted in most parts of the world, and people have used the opportunity to travel across the world. Travelers were willing to spend even though prices have risen sharply this year. In this inflationary environment, we have seen strong demand for our services, helping users save money. We are very happy with our strong operational performance, as we exceeded our own adjusted EBITDA projections. Matthias will cover the details shortly. And I would like to thank our customers and our employees for the strong quarter.

Looking forward, we believe that inflation and labor shortages will continue to drive prices of travel up. We expect consumers to adjust their travel behavior in the next 12 months, going for shorter trips, cheaper destinations and comparing their accommodations more.

In Q3, we have seen first signs of this change in consumer behavior as the length of stay on our platform slightly contracted. And consumers started choosing lower rates, especially in our Developed Europe segment. Nevertheless, we expect the overall travel spending to grow in absolute terms and higher prices to compensate for softer travel demand.

As a business that is helping users to save money, we are optimistic about our outlook for next year. And we'll continue to focus on our core value proposition, as we have done this summer, with very positive results.

Matthias Tillmann - *trivago N.V. - MD of Finance, Marketing & Product, CFO and Management Board Member*

Great. Thank you, Axel. And good morning, everyone.

We are coming out of a very strong summer season in the northern hemisphere, and that is reflected in our strong operational performance in the third quarter.

Our adjusted EBITDA, which excludes an impairment of goodwill and intangible assets that we recorded this quarter, more than doubled compared to last year; and with EUR 33.5 million, was the highest quarterly adjusted EBITDA in the history of the company.

Referral revenue increased 33% year-on-year as a result of higher average booking values, our focus on higher-quality traffic and a healthy auction. The combination of those factors led to strong increases in our revenue per qualified referrals in all regions.

Given there's still some noise in the year-over-year comparison, let me give you a bit more color on our qualified referrals and revenue per qualified referral in the third quarter by looking at the development versus 2019. On a global level, qualified referrals remained stable at above 60% of 2019 levels. Sequentially, qualified referrals increased approximately 20%, and we reached the highest absolute qualified referral volume in July in line with our pre-COVID seasonality.

Our revenue per qualified referral was up 16% versus 2019, mainly driven by an increase in our average booking value, while both our conversion and monetization reached 2019 levels again. So higher average booking values drove a sequential improvement in referral revenue from 64% in the second quarter to 73% in the third quarter, both relative to 2019.

Looking at the regions. In Developed Europe, qualified referrals were at 73% of 2019 levels, slightly down from the 79% in the second quarter. Let me remind everyone that, in the third quarter in 2019, we optimized for traffic volume, in particular in our performance marketing channel, whereas this year we remained disciplined with our spend, optimizing our ROAS for positive long-term return. Hence, the sequential decline is largely driven by the comp effect.

In addition, costs in performance marketing channels increased versus last year due to higher competition in the auction in some of our core markets.

On the Brand side, we were very happy with the performance of our new creatives and, in hindsight, could have invested more into brand marketing in some European markets. However, due to the less-flexible nature of brand marketing spend and our disciplined approach amidst the high macro uncertainty, we took a more cautious approach.

Revenue per qualified referral increased by 8% versus 2019, mainly driven by higher booking conversions and increase in average booking volumes. ADRs were up strongly in Europe, and the increase was only partly offset by shorter length of stay. Monetization was roughly flat compared to 2019.

In Americas, qualified referrals remained roughly stable at around 60% of 2019 levels. We are happy with the results of our TV summer campaigns in that segment and believe we are on a good track to rebuild our brand baseline.

Revenue per qualified referral increased by 32% compared to 2019, significantly more than in other regions. The main drivers were higher ADRs and positive currency effects, which together led to an increase of around 25% in the average booking value.

Length of stay was roughly flat compared to 2019 and hence had no effect on our average booking value in that segment. In addition, slightly higher levels of monetization also contributed to the increase in revenue per qualified referral.

Our segment Rest of World continues to lag in the recovery mainly due to slower recovery in some Asian markets compared to our Western markets and the disruptions in Eastern Europe. Qualified referrals were at 52% of 2019 levels, slightly up from 50% in the second quarter. Revenue per qualified referrals were at 88% of 2019 levels, still down, mainly due to currency headwinds of around 10%, while the increase from higher average booking values was offset by monetization levels that are still slightly lower compared to 2019.

Moving on to advertising expenses. With the increase in travel demand during the peak summer season in western markets, we ramped up our marketing expenses by 43% sequentially, reaching 61% of 2019 spend levels in the third quarter.

Global ROAS was at 148% compared to 123% in the same period in 2019, a result of our improved marketing efficiency and our focus on long-term attractive ROIs. We saw strong results in many core markets with our TV campaigns and increased our investments into connected TV.

Coming out of the summer season in the northern hemisphere, we started to decrease our brand investments and plan to invest only selectively in brand marketing in the fourth quarter, in line with our pre-COVID seasonality.

Excluding advertising expenses, our operational expenses increased EUR 2.5 million in the third quarter or by 8% compared to the same period in 2021. The main drivers for the increase were higher compensation and people-related costs, higher IT expenses and professional fees and insurance costs.

In the third quarter, we reduced some complexity in our business by shifting our focus in product development on our core products. Consequently, we stopped certain projects that we considered to be noncore, like our Weekend product. The resulting reduction in headcount will start to impact our cost structure towards the end of this year and had no effect on our Q3 expenses. At the same time, we incurred cancellation fees related to IT services for products that we have discontinued.

Going forward, despite the inflationary pressure, we expect to be able to reduce our operating expenses in 2023 versus 2022, mainly through the reduction in headcount, by focusing on our core products while deprioritizing noncore projects.

Cash, cash equivalents and short-term investments amounted to EUR 281.5 million as of September 30 compared to EUR 229.5 million at the beginning of the period. The increase of EUR 52 million was mainly driven by a shift of EUR 25 million from long-term to short-term deposits and cash contribution of approximately EUR 27 million from strong operational results in the third quarter.

We continue to be debt free and given our strong cash position and future expected positive cash flows, we are currently looking at different ways to return capital to our shareholders in the future. As an example and as noted in the subsequent events section in our financial statements, we agreed to purchase from Peter Vinnemeier, one of our founders, 20 million Class A shares for an aggregated price of USD 20 million.

Despite our strong operational results, we had a net loss in the third quarter of EUR 67.1 million. Due to the continued deterioration of macroeconomic conditions, including rising interest rates, increased inflation and more uncertainty in respect of the overall economic environment, we recorded an impairment charge of EUR 100.4 million as a result of our annual impairment test.

Our intangible assets were impaired by EUR 52.8 million. And our goodwill balance was impaired by EUR 47.6 million.

As mentioned, our adjusted EBITDA was EUR 33.5 million and EUR 84.8 million in the third quarter in the first 9 months of 2022, respectively, compared to EUR 11.3 million and EUR 51.5 million in the same period in 2019, an increase of 196% and 64%, respectively.

During the last 12 months, our adjusted EBITDA was EUR 104.4 million, with a margin of 20%, achieving our long-term margin goal over a 12-month period for the first time.

We now expect our full year 2022 adjusted EBITDA to exceed EUR 100 million, significantly higher than our pre-pandemic full year 2019 adjusted EBITDA of EUR 69.9 million. For 2023, we expect our adjusted EBITDA again to exceed 2019 levels, and we will share an updated view and more details on our 2023 outlook during our next earnings call in February.

Looking at the recent trends. In October, qualified referrals as a percentage of 2019 remained around 60%, so roughly flat compared to the third quarter. Our revenue per qualified referral continued to be around 15% above 2019 levels as auction dynamics remained healthy. As a result, our referral revenue also remained stable at around 70% of 2019 levels in October. In Europe, both qualified referrals and revenue per qualified referrals remained stable in October compared to the third quarter at around 73% and 105% of 2019 levels, respectively.

Trends in our segment Americas were also roughly stable in October relative to the third quarter. Qualified referrals slightly decreased to around 55% of 2019 levels, while revenue per qualified referrals improved slightly to approximately 35% above 2019 levels. The dynamic of slightly lower volume but higher revenue per qualified referrals was influenced by a large-scale product test in Southern America. As a result, referral revenue was roughly stable around 75% of 2019 levels.

And the picture is similar in our segment Rest of World, where qualified referrals and revenue per qualified referrals continue to be around 50% and 90% of 2019 levels, respectively.

Overall, while the near-term macro outlook remains uncertain, we do not see significant changes in consumer behavior in October. In Europe, consumers seem to try to mitigate the effect of increasing ADRs by searching for more affordable accommodations and choosing shorter length of stay compared to 2019. We started to see this behavior in the third quarter, and this trend continued in October.

In contrast, length of stay is roughly flat in Americas versus 2019, while we also see a tendency of consumers to search for cheaper accommodation. We believe that we are well positioned as consumers shift their focus on cost savings and are excited to help our users during the upcoming winter season and in 2023 to find great deals on our platform.

In summary, coming out of the pandemic, we are a much more profitable business and are encouraged to see that our shift in focus towards profitable growth is paying off.

Going forward, we are determined to grow our business at sustainable rates from current levels.

With that, let's open the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We'll now take our first question. This is from the line of Naved Khan from Truist Securities.

Naved Ahmad Khan - *Truist Securities, Inc., Research Division - Analyst*

So a couple of questions from me. First, on this shortening in the length of stay. Can you maybe quantify that for us. And also maybe talk about, have you seen any changes in the downstream conversion when people click through the links.

The other question I had is around the marketing. I think you spoke about some increasing competition in some of the markets. Can you be more specific as to which markets you're seeing this in? And do you expect this to further intensify? Or just give us your thoughts there.

Matthias Tillmann - *trivago N.V. - MD of Finance, Marketing & Product, CFO and Management Board Member*

Yes. Thank you, Naved. Good questions there. So on your first question, length of stay, I mean, I gave some data points on the average booking value and it's reflected in there. But just to be clear, as I said, in Americas there was no change really to 2019, so it's rather flat.

And then we saw a decrease in Europe and Rest of World. And it's, I mean, to give you a range, between 5% and 15%. It's a bit volatile, but that's kind of the ballpark where we see it for both regions.

And on the downstream conversion in the third quarter, in Americas and Rest of World, the conversion was roughly stable versus 2019, whereas in Europe it was slightly higher. And then in October, that was similar, with the difference in Americas where we saw, relative to 2019, an increase in the conversion rate.

And then on the marketing side my comment there referred mostly to Europe, where we have seen it. And why is that? We have seen in not every country but in a couple of our core markets in that segment that local advertisers stepped up, in particular compared to last year where maybe some advertisers were a bit cautious. And they entered the auction and bid at higher levels, driving up costs.

And as I said, we didn't adjust our ROAS targets. And we continued to optimize for absolute contribution. And that meant that, while maintaining our profitability, we lost some volume there. It is not one thing I can call out for every market. So it's a bit different market by market, but in some markets there were players where, when we look at that, we don't think it's sustainable because, I think, they are not bidding at profitable levels. But obviously that's me speculating what will happen going forward, but in some markets, my expectation would be that, that it could ease a little bit from what we see there.

Naved Ahmad Khan - *Truist Securities, Inc., Research Division - Analyst*

Okay, that's very helpful. A follow-up question, if I may. Talking about the long-term projects, I think you talked about directly bookable hotels and increasing the coverage on those. What kind of time line should we be thinking about there? And just give us some more detail in terms of how you kind of expect to drive monetization here.

Axel Hefer - *trivago N.V. - MD of Legal, Marketplace, People & Culture and Technology, CEO and Management Board Member*

Yes. So on our direct hotel coverage, as we said in the shareholder letter, we have launched a couple of new initiatives that we are quite confident on that, that will make a difference to our coverage relatively speaking soon. So we do think that we will see a noticeable improvement in coverage in the next 12 months.
