Trivago

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Doug Anmuth: We are going to go ahead and get started. I'm Doug Anmuth, Internet analyst with J.P. Morgan. It's our pleasure to have with us trivago's CFO, Axel Heffer.

Trivago is a global hotel search platform. The mission is to be the traveler's first and independent source of information for finding the ideal hotel at the lowest rate. Axel joined trivago as CFO in 2016. Prior to that he was CFO and COO of Home24 AG, an online home furniture and decor company. Also, ND of One Equity Partners.

Welcome Axel.

Axel Heffer: Is it on? Thank you.

Doug: Great. Let's start, can you talk about where trivago sits in the overall travel funnel and what makes the company unique for both travelers and advertisers?

Axel: Sure. trivago is a hotel search company. What we do is we help our users to navigate through all the different offers that are out there.

They start to search on us, we show them all the different hotels that are available that are relevant for their specific trip, help them to select the hotel that they really want to have for that specific trip, show them where they could book it as an availability, and then give them transparency, and where the best price is offered for that specific hotel.

Those are really the benefits for the user. Help in the choice problem, help in the availability problem, and help them in the price, the best price problem. From an advertiser perspective, we give advertisers access to a global user base. We are active in 55 different markets.

We have a very high level of qualification in a way of our users, because they went through the thought process of which hotel they actually want to book. We refer them only at the point in time where they said, "OK. Actually, I like this hotel, so this is what I have a high chance of booking." We think that that is very interesting, and that combination is very interesting to our advertisers.

Doug: You continue to grow at an impressive rate, so about almost 70 percent or so in 1Q.

You've talked about 50 percent growth in 2017. Can you just walk through the drivers of growth? How do you get to that 50 percent as you go through the course of the year?

Axel: Overall the main growth driver of our business is of course an increase in usage. What is driving the increase in usage, we are investing into our brand awareness so that people actually recognize trivago as a brand.

At the same time when you think about our TV advertisement creative's, we are educating the market of what actually the value proposition of trivago is versus using an online traveling agency directly. There we see an increase and usually it's both from the awareness but also the understanding, but understanding of the product.

Obviously, we've got in particular in our rest of the world segment, we have significant increase in penetration. There are markets there we have just recently started to invest into significantly, and that is obviously a driver of growth as well.

When you look at the fourth quarter, that's a general growth driver of the business. When you look at the first quarter specifically, you have got two additional effects that supported this strong growth of 68 percent. One is that we tested a different kind of media spend in the fourth quarter 2016, where we invested more in television than we did in the previous years.

The reason for that was that advertisement is more expensive in the fourth quarter, and that was the reason why historically we have spent very, very little there. We wanted to test what the effect on the fourth but also on the first quarter is, if you drop less in your overall visibility and in return accept higher prices for a TV spend.

That had a very positive effect on the fourth and the first quarters, so that helps in the year-on-year comparison obviously. The second effect that is standing out is that we changed our algorithm, which had a positive impact on our revenue per qualified referral which is our definition of a daily unique user. That obviously helped the revenue development year-on-year as well.

Doug: Let's dig in more there, on the algo change in particular. This is something you talked about a little bit at 4Q earnings earlier in the year. You said maybe it had some positive impact, but it was still early. You wanted to give it another quarter to be certain.

Can you just talk more about...go into more details about the changes that you're making, in particular how it's changing on the advertiser's side once the click through actually happens.

Axel: Yes. Sure. The basic idea behind our relevance assessment is it's a new dimension that we now consider into our marketplace and to our auctions, in a way. The relevance assessment's key objective is to look at the overall user experience across the whole trivago marketplace.

It's not only the individual advertiser and it's not only our product as such, it's really the full user journey that typically starts on trivago, has some interaction with advertiser sites and ultimately obviously ends on an advertiser site with a booking.

To really improve consistency and the overall user experience, we introduced the relevance assessment, which has two key components. One is we assess whether the page that you are landing on when you click out of trivago, whether that is a good or a bad page to land on from a user perspective.

The second dimension of it as we look at the booking funnel in a way, the pages between the landing page and the ultimate booking page, and assess whether that is again good from a user experience perspective.

More specifically, what does that mean? The closer you are to a booking, the better we think for the user, the landing pages. The further away and the more you have to replicate what you've done already from a booking, the weaker a landing page would be in terms of score.

In terms of booking funnel, there are basically two things that we don't think are good from a user perspective. One is a lot of distraction. Advertisement, pop-ups where you should register for a new slash rate cut, these things.

The other thing that we don't really like from a user perspective is any kind of technical means that would make it for you more difficult to return to the main search and in a way, continue your search, which makes it more difficult to go back and forth between advertiser and the trivago main page.

We started that relevance assessment in the fourth quarter, almost like an MVP. It's not done, I would say. It's more of a continuous optimization that we are doing there in terms of defining the parameters and adding more parameters to reflect actually what I just said.

We think that it is a move in the right direction to really take an end-to-end perspective and optimize the user journey.

Doug: What has been the response from advertisers, just in terms of what they've done with the landing page and what you're seeing in terms of conversion rates?

Axel: When you look at the fourth and the first quarter, you can see that there is a pretty positive effect on the revenue for qualified referral, which is positive. It says at the same time that there has not been that much change in those quarters.

Overall, we see that advertisers are optimizing against the new algorithm, as you would expect with any algorithm change. That's why it's a bit too early to say, but we expect in the long term, a positive effect both on the overall booking conversion of the whole ecosystem and also on the user satisfaction, which then obviously has an impact on direct traffic and repeat usage.

Doug: Revenue per qualified referral, and it grew about six or seven percentage or so in 1Q?

Axel: MX adjusted by four, but then the original regions around six.

Doug: You also mention some of that 4Q and 1Q impact there could be mitigated as you go through the course of the year. Why would that be the case? Can you talk about that?

Axel: As I said, in a way from an advertiser perspective, there is now a new dimension that needs to be considered in optimizing the page design and optimizing your bids. When we see on performance marketing trends or changes in the algorithm, we basically look at them and then optimize against them.

We do certain changes on our websites and there are certain changes we don't do because we don't think they make sense. We would expect the same behavior and the same reaction from our advertisers, that they will analyze the changes and then optimize against them.

As a consequence, part of this positive effect will, in the short term, come down. Then a positive impact on the overall conversion and on repeat usage will come with more of a midterm effect.

Doug: Let's shift gears. Talk about you advertising strategy. It's a little different than a lot of the companies that we cover. TV is extremely important for you guys. How have you gotten TV to work so well, and what gives you the confidence that it's sustainable over time?

Axel: When we defined our mission statement in 2008, almost 10 years ago, the situation that we were facing was that we relied very, very heavily on organic traffic from Google. At that point in time, we decided that that wouldn't be a sustainable traffic mix, and wouldn't be healthy for the company overall.

We started to invest, as a relatively speaking small business, into TV. Of course, we didn't do it as well as we do it today. We started to invest. We had a quite low baseline, so we could see very clearly what the effect of the advertisement was. We optimized the advertisement. We spent more.

We went continuously, and that's really something that we do as a company everywhere, and very well. We are very data driven, and continuously analyze what we are seeing, optimize against it, increase the spend further, and we are very much in a test and learn cycle.

By having this approach very early in each market, the data that we could see and the effect that we could see was quite pure, and that helped us a lot to get a good understanding of what initial reaction you need to see to estimate then the overall impact.

In a way, I would say being very focused on it, and being very disciplined, and in almost treating it as a performance marketing channel, the way we are spending on it, and looking very much at the efficiency rather than at the input, which is, I think, an approach that is not uncommon for that channel.

Doug: You started off talking about how you stepped up the spend in 4Q relative to previous fourth quarters. Can you talk about the plan going forward? It sounds like you're going to repeat that again in the fourth quarter this year. How do you think about seasonality in terms of your spend from now on?

Axel: As I said, the test that we did was positive, so we saw positive impact on the fourth quarter, and also on the first quarter. As with every positive test, we'll do it again, and we'll probably test even more.

As a result, the historical seasonality that you could see where the fourth quarter was significantly more profitable than all of the other quarters will be less and less the case. That's what we reflected in our guidance for that. Indeed, as you said, the seasonality and the profitability will come down, and particularly in the fourth quarter.

Doug: You've been doing TV in Germany and Spain, really since 2009. Can you talk about how in some of your more mature markets, how the advertising mix kind of changes over time?

Axel: When you look at the expense split, we don't disclose, but when you look at the revenue split by traffic channel, we've got roughly 50 percent branded traffic, so it's people directly coming to us because they want to use trivago, or using Google as an interface, but then actively still looking for trivago.

That makes it, relatively speaking, stable across the different markets, across the different stages of development, and the reason for that is that when you enter a market, and you start to invest into your brand and also into the user education of people understanding better and better what your value proposition is, you increase your direct user base.

But at the same time, you become more competitive in performance marketing channels, because your click through rate is going up. People understand and recognize you, and understand better what you're actually having to offer.

As a result, it's pretty much growing in line with the brand traffic, so there's not a big mix effect.

Doug: Let's kind of shift into profitability and return on that ad spend. Can you help us understand the different characteristics and returns that you're seeing the rollouts across your three major geographic areas now, and how you expect that to trend going forward?

Axel: When you look at the Americas and developed Europe, you see, historically, that there is an upward sloping trend in a way, and that is what you see on a lower level on the individual countries, and country level as well, that a market, the further it develops, the more direct users it's actually getting, and the less you have to spend for the incremental growth.

That's a typical development, and we think that is a very good proxy for the future development. The rest of the world is a bit different, because there are much bigger mix effects in there.

You've got quite developed markets. You have got very, very young markets, and so when you then move a young market, like last year, India, Russia, and Japan, from testing to scaling phase, then their weight in the overall mix is going up significantly, but then obviously, their profitability is lower than average, because they are very young.

That's why that number is a bit more difficult to read. In developed Europe and the Americas, you have a clearer picture.

Doug: What's your thought there, just in terms of balancing top line growth and growing profitability in expanding margins? You've talked about EBITDA margins for this year being slightly up year over year.

Axel: We continue to believe that the opportunity in the accommodation space is very, very large, and that we are still at the beginning of the overall development. Our key focus is revenue growth. Having said that, in the past, we made very good experience with being very disciplined, and not taking on any additional capital, so the whole company has been built with â‚¬1.4 million.

That discipline helped us to actually force everybody to really think about how to justify the spend that he is suggesting, and so how to measure the effectiveness, and to trade off one opportunity against the other.

We think that is a very good discipline in managing the business internally, and as a consequence, we have decided that we want to keep that discipline, and in a way, artificially set a new baseline which doesn't mean that you couldn't deviate from that if there is a particularly big opportunity, but just for the daily operation of the business.

As you know, we are very decentralized in our decision making. That's why we think it is the right thing to continuously, slowly improve profitability, but we don't think it would be wise to do that aggressively, because you would cut off growth opportunity that would be very, very valuable in the long-term.

Doug: If there's questions in the room, feel free to raise your hand. We can get a mic around. Let me ask one more while you guys are thinking of those. Priceline and Expedia, your two largest customers, combine for a very significant amount of revenue on the platform.

On the one hand, great to have the largest OTAs there, and it shows that the ROI's obviously good for them and helping their business. On the other hand, it's really high revenue exposure. How do you balance those two, and how do you think about the mix going forward?

Axel: It's an interesting question. The first comment on that is that revenue concentration for our business, for our search business, is slightly different than for a normal producing business, because you don't have a product that you can only sell to one customer, so if he drops you, then you just have idle capacity.

We have a user that a lot of people want to have, and the advertisers that bid highest get the revenue share. If they would bid lower, we would still have our user that wants to book a specific hotel, and he would just then be passed on to another advertiser.

What is a lot more relevant other than the revenue concentration, is how many people are standing behind them in line and are willing to take up the volume in case they would become less aggressive, or would reduce their bidding activity.

There it is not so much the share that an advertiser has, but it's the overall dollar amount. The key question from an advertising perspective is really is if this is a channel worth the effort.

Even if your share is 001 percent, but the overall dollar amount is significant enough for you and you as a business, then you will continue to be active on trivago as a performance marketing channel and you will be ready to take on the volume in case the large advertisers would want to bid on, and take that over from them.

Doug: What's the right way to think about that bid density that you have? Has that been changing, at all?

Axel: Yes. We are doing various things to increase the bid density. We are working on connecting direct hotels. We are working on -- particularly in our younger geographies -- and adding more specialized and smaller advertisers, OTAs, etc.

In a way, everything that we do there is having an incremental impact, but it's not that they are revolutionary, big steps that are out there. With the individual hotels, that is more a long-term process. That is how we address it.

We have a free-to-use tool where we think it is important to have a business relationship with the individual hotels early, even before they actively start to bid, themselves. The 280,000 hotels that use our hotel manager product, and then we have a conversion on Hotel Manager Pro, which is a more sophisticated product.

We've got 30,000 people using it, and that is not free. You have to pay for that. We've got a much smaller number of hotels that are directly connecting and directly engaging in the marketplace, but we are very convinced that over time more and more will see the opportunity to directly own their customer and directly participate in the auction.

Doug: Great. Any questions in the audience? One over here. Mic's coming.

Audience Member: Yes. Can you characterize the success that some of these early adopters of hotels advertising directly are experiencing on the site? I'm sure some are doing better than others. Can you qualify what the differences are?

Axel: For a hotel to advertise directly, the key thing is the requirement is that you have a good booking engine that is a good usability, so that people don't drop because they get frustrated with your booking engine.

In a way, that is a prerequisite. If you have that, then hotels tend to be very competitive, because there is a natural preference of users to book direct. Why is that? You have a direct booking with the hotel. You can directly communicate.

You can call up the hotel and add some -- if you have questions, whatever, which you don't have if you go through an intermediary. That's when you are successful with that strategy, but the requirement is really to have a good technology in place so you don't lose too many users for unease of use, because then it becomes very expensive to participate.

Doug: There's one behind you.

Audience Member: There's been much said about the culture of the organization at trivago. I'm curious, from your perspective, how that plays toward your valuation.

Axel: I can only say how it should play to our valuation, since it how it does, it's a bit difficult to say. To me, it is one of the most important points and the reasons for our success.

Because in a way, what we are spending a lot of time on as a management team and as a company is making sure that we attract people that think of their area of responsibility like small companies and are very entrepreneurial and that are willing to take decisions and to challenge every day what they are doing and trying to become better and better every day.

We delegate the decision power to a lot of people and encourage them to really do that again and again and again. If they fail, even if they fail in an expensive manner, we encourage everybody to see that failure not as a failure, but to see that actually as just something that you bought, an investment, because you have negative information.

You know what doesn't work, which helps you to focus even more on thinking about new things that you could try out that might make you better and your part of the overall company better.

With that kind of environment, I think we are doing well. Of course, as in everything, we can do better, and so we are really working hard on maintaining and reinforcing that kind of spirit, despite the fact that we continue to grow very rapidly.

That, to me, is the reason why I'm personally very comfortable that no matter how the market is changing, no matter what which competitor will do, we will, in a way, adapt automatically and continue to be competitive in the marketplace.

That should have a large impact on valuation, but that technically has? I don't know.

Doug: We'll take more in a sec. Let me just ask you, we're seeing some other players and competitors in the space step up their TV marketing spend, realize they may need more of a lowest-price approach and a little bit of a shift in their consumer value proposition. How do you think about that, in terms of impacting trivago?

Axel: It's coming back to the point I made earlier. In the long term, in a way, I think you need to accept that if you're doing something well in a competitive market that other people will try to do the same, and you will be successful or not successful in doing the same. In a way, that is very much backward looking.

Your energy and attention is much better focused on thinking and looking forward and saying how can I become better and what can I change, really, every day to be a better company and not stand still. As long as you continue to change, in a way, it is very difficult for somebody to catch up. That's a bit more philosophical view.

On the recent changes in competitive dynamics, it's difficult to comment on it. We think that showing the best price is a good thing. That's what we've been doing for years and years. We believe in very focused and lean web page design. We believe in very focused brand positioning.

For us, a lot of these things have worked very well. Whether they work well for other people, I don't know. It's difficult to say.

Audience Member: Yes. Thanks. Two questions, actually. The first, what is your relationship with Expedia, now? Is it totally arm's-length, or are there any relationships you still have with them? The second is in terms of the individual, independent hotels. What are you seeing more interest? Is it from smaller chains or the large, global, national chains?

Axel: To start with Expedia, Expedia has been a very good shareholder in trivago since 2013, and what we've done, when we went through the IPO process, we have adapted the existing agreement that was very much -- it gave us basically all the freedom that we wanted -- and translated that into a public market environment.

We have three Expedia representatives on our board and one independent director selected by

Expedia. We've got a very good relationship. They're a very supportive shareholder, but there is no interference in any way into the business.

We are run as a completely separate company, and we think that is important with the growth and the opportunities that are out there to focus on that part of the business. Your second question, on hotels, is the interest stronger with smaller or larger chains, I would say almost all relevant chains are connected to trivago.

In a way, that's what you would expect if you have dozens, hundreds of hotels, then it does make sense to have a connection. I think it is not so much small versus large.

The competitiveness of hotels, as for individual hotels, is predominantly driven by their technology on their own website and the conversion that that technology's offering to convert, then, someone who has decided already to stay in that hotel into a booking.

The better and the more competitive that technology is, the more competitive the hotel chains tend to be on the marketplace.

Doug: We'll take that one in one sec. The algo change, the change you made in terms of relevance assessment, it's a step up, as we're seeing now. Do you have a path for improving commercialization over a period of years?

When you think about the bidding mechanics and the way the algorithms work, are there things you may not want to do, necessarily, right now, but you think over three years, maybe even longer than that, you could see yourself putting into place to continue to improve commercialization.

Axel: Sure. Conceptually, you've got actually two things that matter and that help to commercialize better. One is more competition, so more people participating. The second one is more equal competition.

Anyway, if you just want to take one parameter, as an equal booking conversion as possible of all the advertisers because then everyone is competing head-to-head, then you really reach the optimal result. For both actually dimensions, of course, we are working on various things.

As I mentioned before, we have a conversion funnel for individual hotels to become more and more active on trivago, which is a bit more long term project, in terms of leveling the playing fields in booking conversion and participation in the marketplace.

We've got a couple of tools that are live-ready and we see interest from our advertisers, who are on what we call express booking, which is basically a website that is an optimized checkout process. It is only visible after you've decided which advertiser you would go with, and then that advertiser decides to use that site.

It's a site that we are hosting, but has the look and feel of the advertiser that we optimize across various different advertisers. In a way we have more data to optimize, which is particularly interesting to smaller advertisers to improve their booking conversion.

Another tool that we are providing is automated bidding, where again, particularly for smaller advertisers. We use our data, which is of course, much greater than of the smaller advertiser individually, to help them to come up with the right bids.

It's making them more competitive as well. Then going forward and it would be in that direction more and more things that we are doing, because of course, that is quite important for us and it is important for the overall marketplace to work.

Doug: OK, we will take Juan here.

Audience Member: My question is on your next opportunity. When you are thinking about vacation rentals, some of the large LTs are seeing success there, how do you think about that as an opportunity and do you think the supplier market is ready for that type of inventory being on the meta-search? Would you have price comparison be available on the property level?

Axel: I'll turn to accommodation, I think it is a great opportunity overall for the overall industry, but in particular for search. What is it in particular for search interesting? We think that the mass-market or mainstream, or whatever you want to call it, will become more and more hybrid in their behavior.

What I mean by that, so in the future, you will consider a nice penthouse private apartment rental for a specific trip and a beach villa for another trip, and just a standard hotel for a third trip, and you will not necessarily decide before you go on that trip what actually you are looking for.

You will need a tool, a search that helps you to navigate through this enormous complexity and enormous offering to select the few offers from the hotel space for vacation rental but also for private accommodation that are relevant for the specific trip.

We think that overall, the value that is created by search, I think it is going up. That's why for us as a search business, that is a very exciting development. What needs to happen for that to happen, I think there is one thing, obviously, that has to change in consumer behavior, but that has started to happen already.

The other thing is that for search and good user experience you need instant availability and instant bookability, which is quite important, again, something that has started and that you will see to continue to be rolled out.

Then the last one, which is more the exciting part on the search side, you need to be able to assess the relevance, not only of large hotels, where you've got a lot of data point and a lot of data density, but also for the ultra-longtail, which are then private apartments.

That is something that is from a technological perspective, it is quite exciting and that is something that obviously, we are looking at and we are investing into.

Doug: OK. Great. We are going to do a real quick word association. I give you a word, you just give me the first word or phrase that you think of. TV spend.

Axel: TV spend, very important to us.

Doug: Qualified referrals.

Axel: Our users.

Doug: Expedia.

Axel: Supportive shareholder.

Doug: Revenue per qualified referral.

Axel: Stable.

Doug: Priceline.

Axel: Professional.

Doug: Rollout.

Axel: Upward sloping.

Doug: TripAdvisor.

Axel: Review site.

Doug: Margins.

Axel: Slightly up.

Doug: Google.

Axel: Generally, search.

Doug: Hotel.

Axel: Trivago.

[laughter]

Doug: All right, good answer, all right. Thank you!

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