Trivago

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Brian Nowak: Good afternoon, everyone. We are pleased today to welcome Axel Hefer, the CFO of trivago here. The -- before we get started, I have the typical disclosures and disclaimers I have to read. Please note that important disclosures, including my personal holdings disclosures and Morgan Stanley disclosures, all appear as a handout available in the registration area and on the Morgan Stanley public Website.

So, Axel was appointed as the Managing Director and CFO of trivago in 2016. Prior to joining trivago, Axel was CFO and COO of Home24, an online home furniture and decor company, and Managing Director of One Equity Partners, the private equity division of JPMorgan. Axel, thanks for joining us.

Axel Hefer: Yes, thanks for having me.

Brian Nowak: Lot of interest in the name. It's a recent IPO, right, so just went public in late December 2016. I guess I want to start with, since you've now gone through the IPO process, what surprised you most about the investor conversations maybe even today? And what do you think is still the most misunderstood part of the story?

Axel Hefer: So, yes, I guess the overall process had many surprises. So, from the kickoff early July until the listing in December was quite all right. But, I -- from my perspective, the key surprise in a way is at the same time the part of the story that is least understood, which is when we think about our business, we think about ourselves as a hotel search Website.

And a hotel search site basically has three key value propositions towards the consumer. The obvious one is price comparison, so don't overpay. Where do you have to go to, to get the best price?

The second one, a bit less obvious and taken for granted I would say by many people, is availability. The hotel that you actually want to book, is -- where is it available, which is not always the case on all the platforms because you sometimes have proprietary inventory and capacity.

But, then the key part that people tend to focus on less than we thought was choice. And so, choice is really the search as such. What is really the ideal hotel, as we say in our mission statement, for you on your next trip? And that can be very different by who you travel with, when you travel, what the purpose of your trip is. And that is where, going forward, a lot of the innovation will come from. And that's -- so, I think that's definitely a part of the overall value proposition that people should watch.

Brian Nowak: The innovation going forward you said is primarily focused on the search, or which area?

Axel Hefer: So, yes, it is the search and making the search more relevant. So, just to give an example, which happened to me many, many times and was a bit frustrating, today, on most of the Websites, you can search for gyms. Is there a gym or isn't there any gym?

I've seen it many times that, technically, there is a gym. But, it's hardly a gym. So, it's open only a few hours a day, and it only has one or two pieces of equipment in there. So, that is as good as having none at all.

And so, the difference in scaling of a lot of the dimensions that really matter to you when you search for a hotel, is it a good and a big gym? Is it 24/7? Is it limited availability? Is the spa area big and good? Is it just there? All of these kind of things are highly relevant for you to find the best place that you're really looking for, which is today very difficult with the search that is out there. And that will, over time, become more and more accessible and improve the overall search results.

Brian Nowak: Got it. Got it. I'm sure most people in the room are very familiar with the trivago TV ad campaign, the Hotel Trivago. It's a very effective ad campaign across many, many countries. It's really your bread and butter.

The question is, could you just talk to us a little bit about how your marketing and advertising strategy, how does it work? How do you evaluate the ROI of the ad spend on TV? And how do you differentiate your advertising versus all the other crowded space in the crowded advertising space?

Axel Hefer: Yes, so let me start with the concept of the current campaign. So, the current campaign is set up in a way that we can use the same concept globally. So, we've got the same campaign currently running in 26 different markets with different actors for the different market.

And it is very much driven by Mr. Trivago or Mrs. Trivago (inaudible) on the market explaining what really the product does and how it differentiates. And that has actually two reasons. One is that the understanding of the value proposition of hotel search is still low in most of the market. So, explaining the product is still adding a lot of value.

The second reason why it was set up the way it is, is that we can actually test it in a very modular manner. So, what we do with the TV test before we air them, we pretest them with a proprietary tool. So, since we set it up, we've tested more than 500 different TV creatives so that we more or less know already which works and which spot doesn't work.

And so, then we start to air the spots that were positive on the test. And what then happens is that we then analyze every single airing and make sure that the audience that we are airing the spot is actually fitting the spot. Some spots work for certain audiences. Some work for others. So, we're in a way optimizing then the creatives with the different audiences.

And then we are, of course, optimizing our spend to increase the spend on the audiences with the creatives that work with them and that work and reduce the spend where it doesn't work and then gradually increase the spend.

Brian Nowak: Got it.

Axel Hefer: So, that's the basic idea.

Brian Nowak: Got it. Got it. The -- it's a really competitive online travel space. There's a lot of different Websites out there. And Google had a stat a couple years ago that the average person visits 30 different sites in their travel research process. As you think about your TV spend, can you just talk about loyalty? How do you measure repeat rates or customer lifetime value or retention of the customers that you acquire through TV?

Axel Hefer: Yes, so I would say, overall, across all channels, the way we measure loyalty is by direct traffic. So, we are a search site. And the key benefit of a search site is that you find what you're looking for and then that you can leave the search site.

So, we don't force our users to log in, other than, of course, in the app, but the mobile and the desktop site. So, it is very important that the site actually works and is heavily optimized to find very fast and then refer to the best booking place as fast as they can.

So, in terms of doing cohort analysis or customer lifetime calculations, etc., that doesn't really work for us. That works more for e-commerce business, etc. By having a constant increase of the direct traffic on our site gives us comfort that the overall loyal user base is growing. And what we can then do in addition, we can look at the individual click shares that we see. And there, we see an increasing number of people who go on our site, find something, click, and then book, so do basically all the research on our site.

Brian Nowak: Got it. Got it. One question on the fourth quarter, coming out of fourth quarter earnings, that I often get is you made some comments around commercialization, some tests, some changes you made to the product that led to some positive impacts on commercialization. So, a couple questions behind that. What does that mean? And then secondly, just can you talk through what the impact that could have in 2017 going forward?

Axel Hefer: Yes, so what you see -- as [I already said], what you see in our Q4 numbers is that, in our segment Americas, the revenue to a qualified referral went up quite significantly. And to a lesser extent, that was driven by the exchange rate development. We think it's roughly 5% of the overall effect.

The remainder of the effect is driven by an improved commercialization. And so, what does that really mean? That means, for the same booking value that we refer to advertisers, we make more revenue. So, in a way, it's like a price increase.

And explanations for that better commercialization can actually be one of three factors or a combination of three factors. The first is an optimization in our algorithm. So, we've got a marketplace algorithm that tries to ensure that the advertisers on our platform are actually bidding up to their profitability threshold and that we get a fair share of the value that we refer to them. So, that's one.

The second one is that the advertisers are reducing their profitability targets, which have technically the same effect. We have more revenue for the same booking value.

And the third one is that the rollout of the tools that we are providing to our advertisers, which are in particularly targeting the smaller advertisers and help them to become more competitive, and by them being more competitive, pushing the larger advertisers more in towards the -- again, their pain points of their profitability target. And that would have the same effect.

We think it is predominantly driven by the change in the marketplace algorithm that we constantly test and constantly change. Having said that, there doesn't have to be a permanent effect.

So, what can happen there is something that happened to us in the first and the second quarter 2015, where we introduced the marketplace for the first time, had an improved commercialization, which was coming through the fact that the expensive hotels with the high booking value were basically going to the top of the list in the sorting algorithm. We made more money, but the booking conversion overall went down quite a bit.

So, fewer users of our site found what they were really looking for, but we made more money. So, in the short term, good; in the midterm, actually not what we want. So, we recalibrated the sorting algorithm. And it went down again. So, that is example of a short-term improvement of commercialization that is not really something good, and that is coming back again.

Another explanation for a nonpermanent change in the commercialization could be that the advertisers are actually looking at what is happening, optimizing their bidding strategies, and then mitigating part of that effect.

As a consequence, in our guidance, we said that we would like to see another quarter, potentially two more quarters, of this improved commercialization before we would ourselves review and revise our projections because, at this point in time, it is not 100% clear whether it will be permanent or temporary effect.

Brian Nowak: Understood. Understood. It's a very dynamic auction market. There's always changes that you're making to that. To that very point, one of the questions I had about the auction market is, so right now, it's an auction market where, when an advertiser bids the -- it's the same bid for desktop and mobile.

Have you -- how are you evaluating, or are you evaluating the idea of potentially separating those bids into separate cohorts between desktop and mobile? And if you did that, how do you think about the impact on the monetization in the model?

Axel Hefer: So, of course, we are constantly looking at various different additional bidding options and making the marketplace more granular. So, we started with adding countries as a dimension. And then the next level was the individual hotels rather than hotel buckets.

And to open up another bidding dimension, there are basically two criteria and one thing to consider. The first criteria is, is there a significant difference in booking conversion along that new dimension between the different advertisers?

So, let's not take mobile versus desktop. Let's take audiences. So, one advertiser is converting very, very well for male, the other one very well for female. So, if you would open that up, everybody would bid for the gender that he has the best conversion, and the overall conversion of our site will go up. We make more money. Great.

The second condition is liquidity. So, by opening up a new dimension, you actually -- depending on how many criteria you have, you multiply the number of individual marketplaces in the overall system. And of course, the more marketplaces they are, conceptually the less liquidity is in the individual marketplaces.

It might not matter because they are still very liquid, but it might matter. So, if the liquidity comes down too much, it might very well be the case that the overall booking conversion through our site has gone up. But, we might still make less money because we just can't ensure anymore that we get the fair share of the value that we have created, so great service to -- for the greater cause, but not so much for us and our shareholders. And so, that's the other thing to balance.

And then the third dimension that is -- or the third criteria that is important to keep in mind is the user experience. And so, one of the key benefits we currently have from having a single bid per device is that the user experience is identical. So, the whole setup of the site is very similar for us on mobile versus desktop. But, also, the sorting is identical.

So, you take the underground home from work. You search for a trip you want to do with your wife. You like some of the hotels. You don't have to remember the name of the hotel. You just have to remember what you were looking for. You do the same search on desktop, you see exactly the same results.

And so, as a consequence, we see that the spillover from mobile to desktop is actually quite high for us. And so, putting all those together, we don't see a dimension that in the near term would make sense to add to the current marketplace. But, of course, we are constantly reviewing that. And that could change.

Brian Nowak: Got it. Understood. The only part of the fourth quarter earnings I think that was a little bit disappointing at least versus our numbers, so who knows? Versus our numbers, the qualified referrals in the Americas slowed down a little more than we thought they would. That's an important metric because I think it really speaks to kind of the addressable market for users and referrals.

So, can you just talk a little bit about what drove the slowdown in Americas qualified referrals? And how do you reaccelerate that throughout 2017?

Axel Hefer: Yes, so and you're right. The growth in qualified referrals was a bit less than what we anticipated, not dramatically less, but slightly less than what we anticipated. Having said that, the marketing spend that we put behind that was less than what we anticipated as well.

So, the profitability was slightly higher than what we thought it would be. And the overall revenue growth was slightly lower. So, the reason for that is that a certain portion of our TV spend is not bought through guaranteed airings, but is bought through -- I don't know what the right term is, but where we basically say, at this price and under these defined criteria, we buy what is available.

And so, given that you have -- the TV stations have more flexibility, the pricing is, of course, favorable. But, you run the risk that sometimes you have an overdelivery and sometimes an underdelivery versus what you were expecting.

And in particular, with a region where one individual market has a very, very high share of the overall region, that can have an impact. So, we don't see any fundamental underperformance in the business, and that is from our perspective a key driver.

Brian Nowak: Understood. Your spending on advertising, it's a big driver in the long-term profitability. Your adjusted EBITDA margins were 4% last year. They're expected to be about the same this year, maybe up a little bit around the guidance. It's still quite a bit below your long-term margin target of 25% plus.

I know you're in investment mode now as you push the new markets and things, but can you just help us understand where you are in some of your more mature markets? How many countries have you reached double-digit margins in? And maybe even, do you have any markets that are over 20% yet?

Axel Hefer: So, we have indeed markets that reach the target profitability already today. I guess the way to look at that is that, if you just look at from a regional perspective, developed Europe is -- was in 2016 roughly at a contribution margin of 25%.

And so, that is the blend of all the countries that we're operating in, in developed Europe. So, that is double digit, obviously, if you deduct the overhead, and still shows very, very strong growth. So, we are still investing profitability into growth there.

When you look at the overall business, I think that is slightly unfair, particularly when you look at rest of the world. There, we've got a very, very broad mix of countries, some countries that are still in testing phase, where the key purpose to be in that country is not to make a big profit, but is more to test and calibrate the value proposition towards the consumer and to find out what the best and most effective marketing strategy would be.

And only when you move then the market from a testing to scaling phase, that is where you want to improve the profitability initially, obviously, still not being profitable. And so, there are very, very large investments.

And one country to just pick out would be Japan, where we only recently in 2016 moved that market from testing into scaling phase. But, that is a market that eventually has enormous potential, has a very interesting market structure, and we'll see a lot of growth coming out of that market going forward.

So, yes, long story short anyway, so we see healthy profitability in the more developed markets and still strong growth there. And of course, in the very high growth markets, you need to sacrifice profitability to really build the market.

Brian Nowak: Yes, investment. The other part of the equation I think in the profitability over the long term is going to be the mix of where the traffic comes from between direct, as you mentioned earlier, SEO, SEM, branding, branding channels, etc. Where are you now from a mix perspective between your different customer acquisition channels? And as you manage toward that 20-plus percent margin, how do you see the mix of traffic evolving over time?

Axel Hefer: Yes, so when you -- in terms of revenue derived from the different channels, we derive more than half of our revenue from traffic that originated through branded needs. And what we define as brand is app, obviously, direct traffic, but it's also branded SEM as the input is done on Google, but it is very, very cheap to acquire that traffic, given that nobody can really bid on trivago-specific intent. And so, that's why we categorize it in branded as well. So, it's more than 50%.

When you look across the market, if you just leave out the testing markets for time being, that split is more or less constant. It is not necessarily intuitive. But, the reason for that is, is that, when you scale a market, you invest into TV advertisement. So, your awareness is going up in the market. The understanding of the value proposition is going up. And both of those levers lead to an increase in competitiveness in performance marketing channels.

So, your direct traffic goes up through the increase in loyal user base. But, also, your competitiveness in performance marketing goes up. And so, in a way, it is developing in parallel.

Conceptually, you would expect that, at some point in time, there is no additional benefit anymore that increases your competitiveness in performance marketing so that the brand should outgrow performance marketing at some point in time. We haven't seen that yet in any market, which from our perspective, is a good thing because that shows that we haven't reached maturity anyway yet.

Brian Nowak: The model's really scaled well throughout Europe. You're gaining good traction in the United States. The advertising kind of appears to be your secret sauce. What gives you confidence that it's going to be able to scale to Japan, scale to more markets? What is it that you think really enables you to continue to just go country by country? And do you have any examples of countries where you've made some mistakes and adjusted just to kind of show how you can calibrate your model, the different dynamics?

Axel Hefer: So, in a way, what gives us the comfort is that we spend as much time as we need to test before we really scale. So, we only start to scale and invest significant dollar amounts when we have a good idea what actually does work and what doesn't work and when we see that the value proposition is actually something that is appreciated in the market. And then so, that's the starting point, but that is very important.

Some markets are in testing phase for much longer than others. And so, I guess that's more the reflection of how much you need to adjust and how complicated the local markets are.

The other thing is that we see very, very similar trajectory of the improvement of the profitability of the markets and in a way of the building of the direct user base by market. And having a similar trajectory, of course, gives us comfort to say, in a way, the development is very similar.

The value proposition is in demand in every market. We need to fine-tune it a bit. But, in principle, people want to find the hotel that they really would like to stay in. And they want to get the room availability. And they want to get it at the best price. That isn't really changed by different culture, different language, different origin.

Brian Nowak: There's been a lot of chatter around the macro environment and the political environment around travel, borders, just a lot of new uncertainty over the last couple months. Are you seeing any effects or any changes from a macro or political perspective in your travel demand?

Axel Hefer: Not really. The way we look at our business is very user centric. So, the -- when we say we've got a certain revenue out of the US, for example, that is revenue originating in the US.

So, for any given market, what is really impacting what we see is whether there is overall uncertainty and on future incomes. So, it is very similar to GDP development. As long as GDP is developing nicely, the spend on travel is developing well. And the spend that we see through our platform is developing well. Huge economic crises, of course, have an impact on overall disposable income, traveling, and then on our sites as well.

Brian Nowak: Understood. A little bit around the competition and the competitive environment. Some of your -- well, one of your metacompetitors has really kind of gone down the path of an instant book model of booking on the platform. You haven't gone that direction. Do you need to eventually pivot toward instant book to drive user monetization, or how do you think about instant book versus meta?

Axel Hefer: So, that's an interesting question. To me, to offer instant book, what does that really mean? That has a couple of components. One component that we think is good and what we offer through express booking as well, it facilitates the overall user journey for a specific offer.

We think the bad part about it is that you're not neutral anymore. So, you all of a sudden have a preference for a certain offer, no matter what the price for that offer is, because you monetize better on that specific offer. And that part we don't like. And that's why we would never do it.

We think that, in the long term, to be a credible hotel search Website, you need to be neutral, and you need to credibly convey to the user that you try to find what is best for him or her at the best price. So, to show the best price in what we call champion's position is for us of the highest importance and, in the long term for the brand, I think very important.

So, our key objective of doing the equivalent of express booking is not so much to change the sorting and the way things are presented because that wouldn't be neutral. It is more the step after.

So, you click on something. And then there is for certain advertisers, there is an express booking, which should, A, help the user to speed up the process, but also help the advertisers become more competitive because there is a standard, [in a way], standard booking conversion on that checkout process that we offer that, in many cases, is higher than the Website.

Brian Nowak: Understood. Understood. We have any questions in the audience for Axel? In the front?

Unidentified Audience Member: One thing I'm wondering about is you spent so much money on advertising. And on the search side or on the performance side as well as on the TV side, do you see in the last few months more higher ROIs through certain platforms, like Facebook or Google, or how do you compare that I guess between the different options? And there's many besides those two, but I guess those are the most popular, but then also versus TV and some traditional channels, like radio, things like that?

Axel Hefer: So, just to make sure I understand the question, so your question's whether there are changes in the competitiveness of the different marketing channels that we see recently.

Unidentified Audience Member: That's right, measured by your own tools in terms of how you see their effectiveness.

Axel Hefer: I wouldn't say that we see a change in the competitiveness of the different channels. I think there are trends that certain channels are gaining share or becoming more important. And so, Facebook, for example, as a channel is still relatively speaking small for us, but has a lot of potential. But, then I would say, in general, there are no big changes that we see across the different marketing channels.

Unidentified Audience Member: How's it going? Where is your conversion rate today of your traffic relative to where you think it can be in the medium term?

Axel Hefer: That's a good question. I had a similar question in the morning. I would answer it slightly indirectly. So, in terms of the value that we are providing, which I guess is driving the conversion. The more value we provide, the higher the conversion should be.

When you think about, again, the three buckets that I mentioned before in terms of price comparison, there, a lot has been done already. I think there are a couple of things. They're more personalizing the price comparison more if there are rates that are special to you because you're a member of certain groups or loyalty programs, etc., so to personalize the price comparison a bit more. So, there is more innovation to come there. But, we are quite advanced in the overall functionality.

In terms of availability, I think, there, we are quite advanced and the overall value that can be created through that. In the hotel search, I think we are really at the beginning. And I talked about that a bit earlier. And so, I think that should drive significantly the conversion over the years to come.

So, what that means in terms of overall percentage, are we at 40% or 50% or 60%? I don't know. It's difficult to say. So, but, in terms of innovation in hotel search, there is a lot innovation that should come. In terms of price comparison, there is a bit innovation that will come. In terms of availability, I think we are more or less there, whatever that mathematically adds up to.

Brian Nowak: Great. All right. With that, time's up.

Axel Hefer: Okay.

Brian Nowak: Thank you so much. Thanks, Axel.

Axel Hefer: Thanks, everybody.

Brian Nowak: Thank you.