Prepared Remarks of

theTradeDesk®

Third Quarter 2019 Earnings Call

November 7, 2019

Chris Toth, Vice President Investor Relations

Thank you, Operator. Hello and welcome to The Trade Desk Third Quarter 2019 earnings conference call. Our call today is taking place from our Ventura headquarters. On the line today is our Founder and CEO Jeff Green, and Chief Financial Officer Paul Ross.

A copy of our earnings press release can be found on our website at thetradedesk.com in the Investor Relations section. Before we begin, I would like to remind you that, except for historical information, the matters that we will be describing will be forward-looking statements, which are dependent upon certain risks and uncertainties. I encourage you to refer to the risk factors referenced in our press release and included in our most recent SEC filings.

In addition to reporting our GAAP financial results, we present supplemental non-GAAP financial data. A reconciliation of the GAAP to non-GAAP measures can be found in our earnings press release. We believe that providing non-GAAP measures combined with our GAAP results provides a more meaningful representation of the Company's operational performance.

I will now turn the call over to Founder and CEO Jeff Green. Jeff.

Jeff Green, Founder and CEO

Thanks, Chris. And thank you all for joining us.

I'm going to quickly cover the highlights of the third quarter. But then I want to dig a little deeper into a couple of key areas that are rapidly coming into view in our industry. They will provide context for our performance this quarter, but just as importantly, for our confidence in the fourth quarter and moving forward into next year.

Once again, in Q3 we executed well and exceeded our expectations. We saw revenue grow 38% year-over-year. Revenue was $164.2 million, surpassing our guide of $163 million.

Just so you have a frame of reference for that growth, remember that Magna Global estimates the programmatic advertising market is growing at around 20% this year, and the overall advertising industry is growing at 4%, according to IDC. So, in the fastest-growing segment of an industry that is expected to reach a TAM of $1 trillion in the next decade, we are significantly outperforming. In fact, we are once again growing at about double the pace of the industry.

Our outpaced growth and market share gain are the result of investments we've made in key channels and markets. It's also because of our commitment to objectivity and independence. And it's the work we do across the industry with partners and standards bodies to make this an industry that advertisers and content providers trust.

As you know, one of those major investment areas is CTV. Spend on our platform in Connected TV was up 145% from Q3 of last year. We've seen strong growth in available CTV inventory, especially in live events. We're especially excited about the upside potential for live events in 2020, including major sporting events and the US elections.

After multiple years of triple and even quadruple digit growth in CTV, Q3 year-over-year growth of 145% is definitely one of the biggest bright spots in our business. CTV is the most strategically important focus of our business going into 2020.

We invested early in our CTV infrastructure and in the supplier ecosystem, and we're seeing the payoff of those investments accelerate. I'll say more about this a bit later.

But the growth is not just in CTV.

Audio spending was up a stunning 162% year-over-year. Like CTV, audio is a large and growing market, about $3 billion according to PwC Digital Radio estimates. In terms of pure percentage growth, it continues to be one of our fastest-growing channels. Audio is highly attractive to our customers because it regularly delivers high-performance metrics such as completion rates. We continue to integrate new sources of audio inventory worldwide and expect to see broader adoption of this channel by advertisers in the years to come. Music dominates audio today, but I am just as bullish on other nascent audio opportunities, such as podcasting, in our future.

If you believe, as I do, that CTV and audio are two of the most effective forms of advertising because of high audience engagement, this means that TTD is growing fastest in the forms of advertising that have the most staying power—the most efficacy, not just driving clicks.

And, more and more, the way the world accesses the internet is through mobile devices. This is especially true in high-growth markets of Asia where the largest middle class in history is emerging. In Q3, almost half of our revenue came from ads on mobile devices, which includes mobile video. Mobile in-app spend increased about 58% from Q3 of last year.

In Q3, the move to mobile helped fuel our Asia growth. Spend in our offices in Seoul and Tokyo grew 166% and 65%, respectively. Our Seoul office achieved record spend. We added more major advertisers and more accounts grew their spend with us.

We are seeing similar trends in Europe, where spend growth in our offices in Madrid and Paris grew 75% and 57%.

And in China, we continue to see very promising signs. We hired a new country general manager, Calvin Chan, who was previously the CEO of AdMaster, one of the leading ad tech companies in China. You can think about them as the local equivalent of DoubleClick.

Calvin has already forged a new partnership with Blue Media, one of the largest Chinese media agencies. They see the value working with us to help their advertisers tap into our global footprint. As Chinese companies look to leverage data-driven advertising to market directly to consumers, both within and outside China, there are a few major agencies that they turn to, and Blue Media is one of the largest. Blue Media is partnering with us not only because of the benefits of our platform, but also because of all the work we've done to build the right local ecosystem, including partnerships with Baidu, AliBaba, iQiyi, and Tencent.

This deal is important because Blue Media is one of the local programmatic pioneers in China. As in many emerging markets, much of our go-to-market strategy focuses on educating brands and agencies about the benefits of programmatic. We are taking this to the next level in China, with the launch of a new iteration of our trading academy, The Trade Desk Edge. I'm going to be in Hong Kong and China in the next couple of weeks to record new courses that are specific to the China market. Participating in these sessions will be many of China's marketing leaders from brands, agencies, and standards groups. Calvin has been instrumental in getting all this work in motion.

Through this work, we are laying the foundation for long-term success in China. 2019 has already been a year of significant progress. We are still in the early stages, but I am very optimistic about our ability to drive significant growth in what will be the world's largest middle class in the years ahead. We continue to invest and place bets on China, and we're convinced that we can help Chinese companies grow.

Regardless of channel or region, one underlying constant is the importance of data. As you'll recall, last year we revamped our entire platform to put data front and center in the user experience. In Q3, data was up 63% year-over year. In the last four quarters since that launch, data spend increased about 80% on a year-over-year basis.

We've seen similar gains in cross-device spend. With cross-device, advertisers can target across the range of devices a consumer uses in a way that drives a more pleasant, integrated advertising experience. Advertisers have embraced our cross-device solutions and spend is up 132% year-over-year.

As advertisers become more comfortable with programmatic advertising and the power of data in driving greater precision, they are expanding the types of data they use and becoming more sophisticated in how they apply it.

P&G, one of our bigger customers, summed it up well when their Chief Brand Officer was asked in an AdExchanger article about the power of data-driven advertising. He said, and I quote, "Moving from mass blasting to mass reach, one-to-one precision has helped us get substantial efficiencies in media, which then allows us to grow. That's helped us in the cycle: You raise the bar on superiority, you find ways to get more productive, then you reinvest back in superiority, reach more people, and the cycle continues."

It's that kind of growing awareness of the power of programmatic that helped us sign many new MSAs with some of the world's top global advertisers in the quarter. Among them were a large entertainment company, a global consulting business, a multinational beverage company, a major insurance firm, and global travel marketing company.

As they always do, these new customers have started relatively small as they test the platform, and then they'll grow exponentially into 2020.

When we signed many large brands on our platform in the second half of 2017 and 2018, they, too, began with small campaigns through their agencies. When they saw measurable results, they increased their spend. In some cases, within just two quarters these brands have increased their spend on our platform nearly 800%.

These large advertisers were a key factor in driving our 40% year-over-year revenue growth through the first three quarters of 2019. We expect similar results from our new advertisers.

Among those existing advertisers who are increasing spend with us -- a major auto manufacturer re-allocated significant budget to programmatic on our platform. And we won multi-million dollar incremental spend from a global restaurant brand that had previously relied mostly on one of the "walled gardens" for some of their spend.

These dynamics position us very well for continued growth not only in Q4, but also in 2020. We are more confident than ever in our ability to aggressively grow our business more rapidly and profitably than our peers.

As I said, I want to dig a little deeper to provide you more context for that confidence. I believe we are well-positioned to take advantage of significant shifts in the advertising industry, which make us as competitive as anyone for the next advertising dollar.

Nowhere is this more apparent than connected TV. As we have discussed in the past, the nature of TV viewing and TV advertising is changing right before our eyes. This is significant because, in many ways, TV is the most important frontier in digital advertising.

For many of our customers -- such as major CPGs, retailers, and automakers -- TV represents the largest piece of their massive ad campaigns. Until now, they have only been able to run those TV campaigns based on the very broad demos on linear TV. And they've had very little detailed feedback on how those campaigns perform.

Connected TV is changing all of that. As more viewers access TV content via connected devices and smart TVs, and as more content providers build and launch new streaming platforms, advertisers can apply data to their TV campaigns for the first time. It's a gamechanger.

As I said two years ago, companies like Hulu, AT&T, and Spotify were pioneers of this ad-funded streaming revolution. I said they were what I call tea-leaf companies. If you watch what they do you can predict and know what others are going to do. They developed new TV and audio revenue models. They took strong positions on ad-supported options. In some cases, they offered premium offerings with no ads and in others they offered a discounted offering with targeted ads. These tea leaf companies proved the model, and most consumers choose the ad-funded models. As a result, most of those companies ultimately laid out strategies that went all-in on programmatic ads. Whether any individual tea-leaf company executes well is less important. Some will execute. Some will not. What's undeniable is that these companies have changed the game in streaming content and programmatic advertising.

They were the pioneers. But now it's a movement. AT&T's HBO Max is planning an ad-funded tier. When NBC launches its Peacock service next year, there are reports that it will be entirely ad funded. When Disney launches its Disney+ subscription service soon, it will sit alongside their ad-funded options for properties such as ESPN, ABC, National Geographic, and F/X. Disney also owns Hulu which, of course, has an ad-funded tier and has been leading the fusion of programmatic ads and CTV. These companies and others are giving consumers various ways to pay for the access to their content, and, in doing so, are maximizing their revenue potential.

I believe 2019 is the year that CTV proved that its future will mostly be ad funded.

Given the current economics and the current state of competition in the TV industry, all providers will have to explore ad-funded CTV models. On the linear side, figures from Leichtman Research Group show that the entire traditional linear TV industry lost about 1.53 million subscribers in Q2 2019. Linear broadcasters are fighting for fewer viewers, while content costs are going up. That's a ticking time bomb. For advertisers, that means their ad-to-viewer ratio is worse than ever and, until recently, there's been a sense that they have nowhere else to go.

Now they do. But as more providers shift content to streaming platforms, competition among them is becoming more intense. As we have seen, platforms such as Netflix are fighting tooth and nail for subscriber growth, while having to issue new debt just to keep pace in the war for premium content. There's only so much subscription demand. And there are new competitors every month with massive, established content libraries. It all points to growth in ad-funded models, and I firmly believe that even Netflix will start to experiment with ad-supported services in the future. I believe they'll eventually adopt what others have—giving consumers the choice to pay more and avoid all ads or pay less and see a few highly relevant ads.

And as content providers create and launch their streaming services, almost all of them are working with us to figure out how to optimize for programmatic demand. We announced the details of a private marketplace agreement with Amazon. This deal is a game changer for the industry and represents another tea leaf offering. We are now one of their preferred DSPs for third-party premium content in their Fire TV marketplace. We have access to all their premium content inventory, not the remnants. And as Amazon Publisher Services stated when we announced this deal, they are coming to us in order to maximize demand, to ensure fee transparency for the advertisers they are trying to attract, and to improve ad frequency for consumers.

As you may have heard, we have also started to work with Disney as a preferred partner, as they start to stream more of their premium content.

Let me just pause a moment and reiterate. These content providers are not our direct customers. They are our partners. More and more they are asking to work with us. It's not just Amazon and Disney, as it's other major global providers worldwide including Channel 4 in England, Prosieben in Germany, TF1 in France, and pretty much every other significant network and content provider.

They are coming to us because they want to make sure they do everything right so that advertisers can apply data-driven strategies to their content.

On a more micro level, what did all this mean for us in the quarter?

Three things. First, as the quarter progressed, more and more premium TV inventory became available on our platform, and more of our customers started to access it. This helped drive revenue growth acceleration for us as we moved through the quarter. As a result, our last month was especially strong in CTV growth. That's in part the result of inventory coming online from partners such as Amazon, and Disney. With Amazon, the number of impressions on our platform increased 21x during the quarter. But we are also seeing game changing progress from other partners.

For example, Freewheel, the largest ad server in the CTV space, launched their version of header bidding—unified yield. This is the best thing for them to offer content owners, but it also means, in a nutshell, that we can compete on every impression. As always, if we can level the playing field, this becomes a fight between data-driven ad selection and guessing. Whenever this is the challenge, we're confident we'll win way more often than we lose. As a result of Freewheel's leveling the playing field, we saw available CTV spots increase significantly through the quarter, up as much as 300% with some premium content providers using this new feature on Freewheel.

Second, upfront commitments by major brands to programmatic TV advertising campaigns, which were signed back in the spring, started to go live in late August and September, as broadcasters launched new content.

And last, but perhaps most interesting in terms of the fundamental difference between linear and connected TV advertising – is live sports. Let me spend a minute here. The unpredictability of live events is a huge opportunity for both content providers and advertisers. If you look at what Disney is working on with us, as they build their streaming platform, it's all about optimizing the value of unpredictability.

Think about it. A major league baseball playoff game goes into extra innings or an NFL game goes into overtime. This is when viewership is at its highest and most engaged levels. Everyone's watching. This should be the broadcaster's most valuable ad inventory, and the most desirable for the advertiser. But in a linear environment, these ad spots are often wasted. The advertiser can't plan for them and the broadcaster often ends up giving them away at a discount for repeat ads. In a data-driven environment, the advertiser can optimize for those opportunities, automatically recognizing value and shifting investments in real-time. The broadcaster can then realize the full value of those spots.

As the third quarter progressed, we saw the NFL kick into gear, college football start, baseball playoff races were heating up, and the start of the European soccer season. All of these are huge opportunities for our advertisers. And this momentum will stay with us through the quarter and into next year, where we'll have not only major sporting events which will continue to benefit from programmatic TV advertising, but also highly charged political events, such as the presidential election, which will also drive unpredictability in content.

All that said, not only did CTV help drive revenue growth acceleration for us through the quarter, I firmly believe that CTV advertising is coming of age right now. It will fundamentally alter the economics of television moving forward – in a way that will benefit The Trade Desk.

This shift is important in another context too. The progress we have seen in CTV is a direct result of the investments we've made in our platform and in our partner ecosystem.

This commitment to investment is a major differentiator for us. Advertisers recognize that we are always investing to help them be as successful as possible.

As I have said almost every quarter, we retain the financial flexibility to invest wherever necessary to stay at the bleeding edge of our industry. And that's not just in CTV.

We're building on our AdBrain acquisition and investing heavily in identity graph solutions that enable our customers to drive data-driven precision in their campaigns, whether they are operating in a cookie-based or cookie-less environment.

Our investment also includes areas such as measurement, as advertisers look for the most precise information on campaign performance. Our measurement tools allow an agency or advertiser to use third parties for verification. This helps the ecosystem become more transparent and avoid the "grading your own homework" syndrome that advertisers experience with walled gardens, and which often obfuscates ROI and data.

We also continue to invest in our infrastructure to support business and data processing growth worldwide. You already see some of these infrastructure investments flow through to our "gross margin," or platform development expense line. It is these types of investments that help drive leverage in our model.

We do not have to choose between growth and profitability. We do both. This is highly appealing to our customers and a major factor in our 95%+ retention rates. They know we will continue to invest for their success. This puts us in a position of strength. For companies of similar size and profile, we are growing faster, and we are significantly more profitable. I believe that profitability is good business discipline. It forces us to focus on how we're delivering premium value – and we constantly make sure that the value we're providing exceeds the fee we charge for our platform?

That focus is driving more major brands and agencies onto our platform. It's what's prompting a major beverage brand to work more closely with us to apply advanced tools to improve frequency management across all digital advertising channels. It's what's driving all the major broadcast providers to work with us as they strategize on their new streaming platforms.

I've covered a lot of ground, but I think it's all important to understand what's going on in our industry, and our position within it. This is a fascinating time for data-driven advertising, and given everything I've discussed, I feel very confident that we are well-positioned to continue to lead our industry and drive momentum for our business.

As we exit 2019 and look forward to 2020, there are six specific areas that make me extremely positive about our future prospects.

First, brands and agencies are driving more data-driven strategies across their campaigns to stay competitive and protect their brand value. This is good for them and it is good for us. In the long run, moving to data-driven choices leads advertisers to global, omnichannel platforms like ours. Over time, we expect to see the amount of data per impression increase.

Second, we have more large advertisers on our platform than ever before. More than 70% of the AdAge Top 200 Advertisers have spent on our platform in the last 12 months. Despite this momentum, we still see significant growth potential as data-driven advertising becomes an ever-larger element of their campaigns. As a result, their current spend with us is still small relative to what we expect them to do in 2020 and beyond.

The third area is connected TV. As I discussed, the progress we have made in adding premium inventory supply from the likes of Amazon, Disney, and others is driving more and more advertisers to apply data to their huge TV ad campaigns for the first time. This has helped our CTV spend increase materially. We expect CTV growth of over 100% again in 2020.

Fourth, global expansion. We have made significant investments outside the US over the last two years. We believe we are in a position to accelerate our international growth in 2020.

Fifth, we continue to invest heavily to stay at the forefront of innovation in our industry. We have seen major success with products such as cross-device, data, and identity solutions and expect to continue that trend with new products that we launch in 2020.

And finally, we have extremely strong customer retention rates and expect to maintain those rates even as we expand our customer base. This model of excellence in customer service has fueled this business since its inception. Our goal is to continue to offer the best scaled objective media buying platform in the world.

All that said, and with all that great momentum, we're still just getting started. As our numbers quarter after quarter show, The Trade Desk is growing much faster than the market. We anticipate these trends will continue for the rest of this year and into 2020.

Now I am going to turn the call over to Paul to discuss our financials.

Paul Ross, CFO

Thanks, Jeff, and good afternoon, everyone.

Q3 was another record quarter for The Trade Desk and we were pleased with our Q3 financial performance and execution. Revenue increased 38% year-over-year, Adjusted EBITDA increased to $47.8 million, a Q3 record and, and Net Income was $19.4 million. This marks our fourteenth consecutive quarter in a row of GAAP net income – all while we continued to invest aggressively for future growth.

Revenue for the third quarter was a record $164.2 million, which was above our expectations, and reflected increased spend by our existing customers and the addition of new customers and advertisers. For the quarter, approximately 89 percent of our third quarter gross spend came from existing customers who have been on our platform for longer than a year. Q3 marked the twenty-third quarter in a row where customer retention was over 95%.

With the growth of our business, our operating expenses grew to $142 million in Q3. This increase was primarily due to sales and marketing and engineering as we continue to scale for future growth. The year-over-year increase also reflected higher G&A expenses which takes into account stock-based compensation.

GAAP Net Income was $19.4 million for Q3 or $0.40 per fully diluted share.

Our adjusted net income was $36.1 million or $0.75 per fully diluted share compared with adjusted net income of $30.2 million or $0.65 per share in the comparable period last year.

Adjusted EBITDA was $47.8 million with a corresponding margin of 29.1% of revenue during Q3 2019. The increase in adjusted EBITDA dollars reflects the strong growth of our top line, partially offset by our increasing investments across our operating expense lines.

Net cash provided by operating activities was about $67.5 million for Q3 and our trailing twelve months of operating cash flow and free cash flow were $136 million and $100 million respectively. As a reminder, the timing of our payments and receivables in any given quarter can swing our cash from operations significantly.

We have zero debt on our balance sheet and our cash and short-term investments position continues to climb, exiting the quarter at $297 million.

Our DSOs at the end of Q3 were 96 days, a decrease of four days from the same period a year ago. DPOs for Q3 were 77 days, also a decrease of four days from the same period a year ago.

For Q4 of 2019, we are expecting revenue of $213 million and Adjusted EBITDA of $78.5 million.

And for the full year 2019, inclusive of our guidance for Q4, we now expect revenue for the year to be at least $658 million which approximates to 38% growth year-over-year, and the corresponding Adjusted EBITDA to be $209 million or 31.8% percent of revenue.

With that, I will hand it back to Jeff for any final comments, and of course, Q&A. Jeff.

Jeff Green, Founder and CEO

Thanks, Paul.

Q3 was another very encouraging quarter for The Trade Desk as we continue to see our strategy and execution pay off as more advertisers commit their budgets to us. We exceeded our expectations for the quarter and are raising them for the year. The fundamentals of our business are solid, and we continue to scale across markets and channels.

Looking at the rest of 2019, we anticipate a strong Q4. The advertising commitments that were made in the television upfronts earlier in the year are now kicking in. And, of course, the holiday advertising season traditionally makes Q4 the strongest quarter of the year.

We see similar opportunities in 2020. We expect another strong growth year in CTV, fueled by live events such as the US elections and sporting events, and more quality inventory than ever on our platform.

As the worldwide advertising market moves towards a trillion dollars, The Trade Desk is perhaps the best-positioned company to win the largest share of the programmatic portion of that market, the fastest-growing segment.

We feel confident in our strategy, our investments, and the momentum we are seeing from both advertisers and content providers. We see nothing but upside ahead.

That concludes our prepared remarks. Operator, let's open it up for questions.