Prepared Remarks of

theTradeDesk®

Second Quarter 2019 Earnings Call

August 8, 2019

Chris Toth, Vice President Investor Relations

Thank you, Operator. Hello and welcome to The Trade Desk Second 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 excited to announce that our revenue growth accelerated to 42% in Q2 compared with 41% last quarter. Our accelerating growth is a testament to the increasing trust that major global advertisers are placing in us as they shift more of their advertising dollars to programmatic.

To understand the significance of our growth, we need to provide context for what is happening to advertising from a macro perspective.

In 2019, according to IDC, global advertising spend will be about $725 billion, up over 4% from 2018. At current growth rates, global advertising will be a trillion-dollar industry in about seven years, one of only a handful of industries with a TAM over that mark.

Programmatic is still a relatively small part of total global advertising. It is estimated at around $34 billion in 2019. But it is growing 5 times faster than total advertising at around 20% year-over-year, according to Magna Global. We maintain our prediction that, before long, most advertising will be digital, and nearly all of it will be transacted programmatically. This puts us in the fastest growing segment of an expanding industry where we expect to continue to aggressively take share.

We saw this in our results last year. We are continuing to outperform the industry again this year which is reflected in our biggest Q2 to date. But more significant than comparing our company's performance now to our performance in the past, our growth rate is 10 times the pace of overall advertising growth. In fact, our growth is nearly 4 times the growth rate of digital.

There are many reasons for our industry-leading growth rate. Some of our growth is coming because we're executing well and capturing opportunities. But other growth drivers are secular. The digitization of advertising, particularly TV, is massive. The shift to data-driven decisioning versus guessing or intuition is game-changing. These changes in the landscape significantly benefit us. We have created our strategy, our technology and our business model to take advantage of these shifts.

As a result, more advertisers are standardizing on our platform.

Every brand and every agency knows that they need to be engaged in programmatic advertising—which is another way of saying that every brand has come to understand that advertising using data-driven decisions is much more powerful and effective than simply following intuition alone. Our results are proof that this is occurring.

For example, in the second quarter, we signed 55 new MSAs representing some of the largest brands on the planet. This is the highest number of new MSAs we have signed in one quarter since the end of 2016. Through the first half of the year, 60% of the Fortune 500 companies are now growing advertising through The Trade Desk.

More brands -- nearly 50,000 of them, mostly through their agencies, are moving more of their ad budgets into data-driven advertising. These numbers are very telling because once advertisers embrace this model, they start to shift more of their budget into it. Once one person on an agency account or at a brand starts to realize the value of data-driven precision, then others start to adopt it across more channels. We see evidence of this everywhere.

For example, in Q2, EMEA had continued solid growth and share gains. Our offices in both Madrid and Paris achieved record spend in Q2. We added more major advertisers and more accounts grew their spend with us. During the quarter we added a large regional hotel chain and a smart home energy company, to name a few.

We are seeing similar trends in APAC, where our offices in Hong Kong, Jakarta, and Sydney all achieved record spend. We're also seeing exciting growth in many of Asia's fastest growing emerging markets. eMarketer defines Southeast Asia as Singapore, Indonesia, Thailand, Malaysia, Vietnam, and the Philippines. They predict digital mobile growth there to be about 35% in 2019. In several countries we are growing exponentially faster than that. For example, in Vietnam we grew 125% year-over-year.

In these smaller, but fast-growing markets, data-driven advertising is the perfect fit. The cost of sales and distribution is way lower, and market-moving shifts require adoption from fewer people. I continue to predict that these emerging markets will be nearly 100% data-driven before the US.

To continue growing demand in these emerging markets, you have to grow supply. That's why I'm excited about the premium inventory partnerships we have developed in Asia. For example, in Thailand, we access the country's top TV digital platforms, Channel 7 and Channel 3. We also access TrueID TV, the second-largest broadcaster in Thailand. In Vietnam, we partner with the largest free TV station, VTV.

Globally, our commitment to invest and innovate in the channels that matter most to advertisers is a major driver of growth for The Trade Desk.

In Q2, 47% percent of spend on our platform was in mobile. A new record. Mobile video spend growth was about 50%. Mobile in-app spend growth was about 63%. Data spend again was up 80% and cross-device spend was up over 250% for the third quarter in a row. Audio, which I believe is the best value in programmatic today, grew over 270% in Q2 for the second quarter in a row. Connected TV spend growth was also amazing, growing nearly 3x from a year ago.

I have said before, we will likely never see a channel larger and more full of opportunity than we have right now in CTV. Much of what we've done over the last decade has simply been a dress rehearsal for the digital shift happening in TV right now.

This is important because as we drive toward a $1 trillion total advertising market by 2027, about half of that market will be in some form of video. And most of that will be in premium TV.

We are at the very beginning of the digitization of TV advertising. More and more consumers watch TV content through connected devices. As they do that, advertisers are getting a much better understanding of who is watching their ads, and how they are responding. This enables advertisers to apply real data to their large TV ad campaigns for the first time, making those campaigns more precise and effective. This kind of targeting is simply not possible with linear TV.

This is especially important for major consumer brands, who are among the most aggressive in embracing data-driven advertising. For them, brand differentiation is critical. They are facing unprecedented margin pressures in their core business. Getting smarter, more precise, and more scientific about how they invest their ad dollars is a very effective way of maintaining and enhancing brand value.

And nowhere is this more apparent than in TV.

Every discussion I have had over the last few months with advertisers or content providers starts with the potential of connected TV. It was the number one point of discussion during the recent upfront season, and at the recent Cannes Lions conference. Every top advertiser wants to know how they can best access CTV inventory at scale and how they can apply programmatic to it. On the publisher side, all the major premium TV content providers in the world want to know how they can make more of their premium content available for programmatic demand. This is driving our premium inventory supply growth that we see every quarter. In Q2 our CTV inventory growth was up over 3x from a year ago. But our momentum does not stop there.

It was recently announced that Amazon Publisher Services is working with The Trade Desk. This is a breakthrough deal in CTV for several reasons.

As always, let's start big picture and then zoom in on what this means directly for our business and our advertisers.

This announcement is a victory for the open internet. So many decisions by big tech players have created walls around their content and reduced transparency for advertisers. In this deal, I believe Amazon has taken a different path. By making this announcement, I believe they are staking four claims:

1. They are joining the open internet.
2. Aside from advertising on Amazon.com they are centering their efforts on the sell-side
3. They are going to reduce the cost of sell-side fees significantly while being completely transparent, and
4. They are partnering with the demand side instead of the go-it-alone strategies that the walled gardens often deploy.

Let me tell you why I believe these points are significant.

Advertisers on our platform have now have access to 100% of Amazon's third-party content providers – think Discovery, NBC, and ESPN apps on your Amazon Firestick. This is quality inventory on premium content.

With APS, we have a joint focus on improving the consumer experience by doing better with ad frequency. Amazon is providing an anonymized ID, very similar to the IDFA anonymized ID that Apple shares in its mobile ecosystem. We can use this to measure reach and frequency across the entire internet. It also allows brands unlock the power of their own data and insights, their most valuable data, to drive ad relevance across the TV ecosystem.

In so doing, Amazon Publishing Services is supporting the open internet, in contrast to big tech walled gardens. It's a strategic move which I believe will put significant pressure on other CTV aggregators.

And finally, Amazon is being transparent about their fee structure, and exactly how much the publisher will receive, something that's very important to us and something I'll come back to shortly.

We are equally excited to be working with other major TV content providers. For some of them, it's the realization that more than 50% of their viewership is now coming from connected devices. For others, it's the realization that live TV events, such as sports and political debates, are driving massive new viewership on connected devices. They need to overhaul their models to allow for ad price optimization during unpredictable spikes in demand. This requires a new business model and these providers are coming to us to partner on that strategy work.

We are driving similar relationships internationally. In Europe, for example, we are working directly with many of the largest media companies, such as RTL Group, Proseiben, Mediaset, and others.

Across Asia, we have access to many of the top OTT video streaming services such as TVB, HOOQ, iflix, VIU and LINE TV, just to name a few.

Across all of these relationships, our focus is on monetizing premium ad-funded content. This contrasts with walled garden platforms which prioritize user-generated content. Premium content is more valuable to advertisers because it is much higher quality, it's inherently more brand safe, viewers cannot skip through ads, and there are better content-to-ad ratios.

This shift toward premium content will also force big walled garden platforms to re-evaluate their take rates and margins. All-in they are operating at something like 50% today. Emerging platforms, including Amazon and others who are just starting to make their content available, are operating at a fraction of that, and often with significantly more premium content.

In this environment, more advertisers, such as The Hershey Company, are shifting more of their campaigns to The Trade Desk. In fact, Hershey has consolidated much of its programmatic advertising on our platform. They have gone from several DSPs down to just one, which gives them simpler line-of-sight into the effectiveness of their programmatic campaigns. They share our view that data analytics, transparency and user experience are critical to driving greater effectiveness. As they emphasize TV across all their campaigns, they saw, in The Trade Desk, a partner who can help them drive greater relevance and success. They have built a small internal team at Hershey that manages their agencies and their relationship with us. That team focuses on areas such as audience targeting, social media marketing, and data science. They are building in-house programmatic capability because, like an increasing number of major advertisers, they want to get a much better handle on supply transparency.

Which brings me to another major point I want to make.

Since our last report, we have started to see a lot more regulatory focus on Big Tech, and much of it has to do with how they manage their ad platforms and the consumer data that they manage through it. Many of you have asked what this means for our industry, and for our company.

To answer that, I want to take a step back, and try to give you some context as to why we do what we do. Because I don't think we've talked enough about this or taken enough credit for the pressure we are putting on the advertising ecosystem to be more transparent about data, pricing, and value.

As I mentioned before, the total addressable market for the advertising industry is on a growth march toward $1 trillion, driven by growing demand from advertisers to apply data to their ad campaigns and drive greater precision and relevance. This growing ad market is also driving the internet as we know it today. This includes not only content delivered over computers and phones. It's also internet-fueled TV that is right now the most exciting growth area within advertising.

But to sustain that great content, advertising must keep up and keep innovating. In the near term, as CTV advertising grows rapidly, that means fewer ads with greater relevancy.

But the data that will fuel more relevant advertising won't come from TV viewing data alone. It will come from where you click on your many devices, what other content you interact with, and an understanding of what else you are interested in.

So let me give you a sense of how we approach data, and how we put it to work, and a couple of the initiatives that we have pioneered in our industry to improve transparency, confidence and the power of data analytics.

We have a very consumer friendly position on data. We do not transact in directly identifiable data. We don't want the data that comes from owning a search engine and we don't want the personal information and social graph that comes from operating a social network.

We don't need it. And this is a huge distinction for us when compared to the walled gardens, who are under huge scrutiny on this issue. We don't know your name, your address, or the details of your health. We know about the products you're interested in and the content you tend to like. We can put that data to work to help our advertisers build an understanding of the kind of advertising that should be relevant to you.

All this data is anonymized. Our acquisition of AdBrain has been hugely important in our ability to advance this kind of work. AdBrain's AI helps us integrate insights across environments in a way that protects consumer data by using only anonymized information. This is a differentiator for our advertisers who are hyper-focused on protecting the integrity of their consumer relationships, which sometimes go back decades.

But let's look a little closer. Because of our leadership position on the demand side of advertising, advertisers also expect us to leverage that position to apply pressure to the supply side of ad tech.

And over the last two or three years, we have done exactly that, often behind the scenes. And in doing so, we have used our strong position as the leader in the open internet to make the internet better.

As we do this, our focus is on improving the ad ecosystem for all players, so that everyone benefits. We firmly believe that the more transparent the ecosystem is, the more confidence advertisers will have in it and the more demand they will drive.

That's why we developed, and then gave away, our Unified ID solution. As the largest independent demand-side platform, we have a massive cookie footprint. Leveraging this scale through Unified ID radically improves match rates across the ecosystem. This is true even when the transactions aren't on our platform.

Both demand- and supply-side companies can use Unified ID to drive a much more transparent view of users across the ecosystem. This is all done anonymously with no directly identifiable information. We have seen match rates go from what was considered decent by industry standards, around 50-60%, to close to 100%, for those who use Unified ID. On the supply side, we have seen CPM's more than double in some use cases.

Every day, more and more companies are deploying it. It's great for advertisers, who have a much cleaner view of their market. It's great for publishers, who can drive greater value. It's great for other DSPs as it takes one of their major challenges and radically simplifies it. And it's great for us. While it may seem counterintuitive to create this technology then give it away, we believe that it helps create a growing, competitive market. And we believe we will take an outsized share of that market.

Another major initiative on the supply side has been our partnership with White Ops to scrub all ad inventory for fraud. Three years ago, if you were at any digital advertising industry conference or event, the number one issue was fraud. Advertisers were worried that they would inadvertently buy fraudulent ad spots.

The problem at that time was that those companies who claimed to help advertisers manage fraud were really just taxing it. Their vested interest was not in preventing fraud itself but taxing it – levying a fee for layering their technology on to every impression.

Working with White Ops, we upended that model. We wanted to scrub all inventory before it ever came to the buy side. They reduced their rates and we significantly increased their volume by insisting all our suppliers work with them. In doing this, we put pressure on the entire ecosystem, big and small, to scrub for fraud. Our leverage was such that we could take this position, make it affordable, and make it pervasive. And today, this is not a major issue in our industry anymore.

These are just a couple of examples of how we are working to improve the digital ad ecosystem for all parties. There are many others. As I mentioned before, I don't think we've taken enough credit for the work we've done, but I think in the context of all the scrutiny of our industry right now, it's important to understand how the industry is changing, what's driving that and how The Trade Desk is creating value.

There are times when some supply side players get uncomfortable with these efforts to improve transparency and efficiency. That's because many of them are trying to protect business models that drive high margins while providing comparatively little value. But this is the natural cycle of a maturing industry. Transparency will force price and value discovery and every market participant will ultimately have to account for the value they provide and the prices they charge. In this climate, I don't think it's coincidental that our business continues to thrive, and more advertisers standardize on our platform. They want to align themselves with a partner who ensures they can act with transparency, objectivity, and integrity.

Finally, as I have stated many times before, we believe our business model is exceptional. We have the luxury to not have to choose between growth and profitability. We are doing both and we have pretty much done so since the beginning. In Q2, our financial performance, and particularly our $58 million of adjusted EBITDA was significantly better than we had estimated. So I want to give a little context.

We've increased our operating spend by more than $41 million year-over-year in Q2. This means our investment was up 50% over the previous year. Even at that rate, we couldn't invest fast enough. Of course, part of that is our investment discipline. We invest quickly but carefully, always focused on the needs of our customers worldwide. We are also careful to ensure that we maintain our culture, which we believe is key to our success. In Q2, some of the hiring and investments we did not complete are already happening in Q3.

As a result, we expect adjusted EBITDA to be $45 million in Q3. If we expect additional investments will lead to an outsized return, we will invest as fast as we can. That is how we operate. We consider this a position of great strength. We can produce EBITDA margins that meet or beat most other SaaS companies, including those much bigger than us.

So hopefully you have found this context useful as you think about the nature of the market that we operate in, and why we believe we will continue to grow share in the fastest growing part of it, data-driven advertising. Our focus is on advertisers and agencies, our commitment to the open internet and everything that means in terms of transparency. Our pragmatic approach to rapidly investing our profits in future innovation, means that we will accelerate our leadership in this market. With the biggest shift in media and advertising we've seen in a generation now underway; we are in a great position to grow share moving forward.

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

Paul Ross, CFO

Thanks, Jeff, and good afternoon everyone.

As you've seen in our press release, Q2 was another outstanding quarter. Revenue increased 42 percent year-over-year and accelerated vs. our Q1 growth of 41%. Adjusted EBITDA increased to $58 million and GAAP Net Income increased nearly 45% to $28 million. We achieved this while we continued to invest aggressively in areas critical to our future growth, such as on our platform and adding engineering and sales talent. ///

Revenue for the second quarter was $160 million, which was above our prior expectations, and reflected increased spend by our existing customers plus the addition of new customers and advertisers. For the quarter, approximately 89 percent of our second quarter gross spend came from existing customers who have been on our platform for over a year. Q2 marked the 22nd quarter in a row where customer retention was over 95%.

With the growth of our business, our operating expenses grew to $128 million. This increase year over year was 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, and we expect G&A to moderate as a percentage of revenue in the back half of the year.

Income tax was a $5.6 million expense in the quarter mainly due to the tax benefits associated with employee stock-based awards, the timing of which can be variable.

GAAP Net Income was $27.8 million for Q2 or $0.58 per fully diluted share.

Our adjusted net income was $45.6 million or $0.95 per fully diluted share compared with adjusted net income of $27.2 million or $0.60 per share in the comparable period.

Adjusted EBITDA was $58 million with a corresponding margin of 36.2% of revenue during Q2. The increase in adjusted EBITDA dollars reflects the strong growth of our top line, offset by our increasing investments in product, people, global expansion, and corporate expenses.

Net cash provided by operating activities was $11 million in Q2 and our trailing twelve months of operating cash flow and free cash flow were $95 million and $60 million, respectively.

We continue to have zero debt on our balance sheet and our total cash, cash equivalents, and short-term investments exiting the quarter was $231 million.

Our DSOs at the end of Q2 were 102 days, a increase of 1 day from the same period a year ago. DPOs for Q2 were 81 days, a decrease of 1 day from the same period a year ago.

For Q3 of 2019, we are expecting revenue of $163 million, and Adjusted EBITDA of $45 million.

For the full year 2019, we now expect revenue to be at least $653 million, revised upward from $645 million last quarter. Adjusted EBITDA is now expected to be $201 million, also revised upward from last quarter, or about 31% percent of revenue.

I will now turn the call back to Jeff for final comments and, of course, Q&A. Jeff…

Jeff Green, Founder and CEO

Thanks, Paul.

Q2 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 our business across markets and channels. As the worldwide advertising market moves towards a trillion dollars in a few years, we are well-positioned to win a large share of the programmatic portion of that market, the fastest-growing segment. We invested early in key markets and channels and, while we are pleased with our initial gains, we see far more upside yet to come.

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