Prepared Remarks of

theTradeDesk®

Second Quarter 2020 Earnings Call

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Chris Toth, Vice President Investor Relations

Thank you, Operator. Hello and good afternoon to everyone. Welcome to The Trade Desk Second Quarter 2020 earnings conference call. On the call today are our Founder and CEO Jeff Green, and Chief Financial Officer Blake Grayson.

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, some of the discussion and our responses in Q&A may contain forward-looking statements, which are dependent upon certain risks and uncertainties. In particular, our expectations around the impact of the Covid-19 pandemic on our business and results of operations are subject to change. Should any of these risks materialize, or should our assumptions prove to be incorrect, actual financial results could differ materially from our projections or those implied by these forward-looking statements. 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

Hello everyone and thank you for joining us.

It's no secret that the last several months have been among the most trying times for all of us. The global pandemic has changed the way every business in the world operates. For us, The Trade Desk team continues to be resilient, supporting our families, friends, customers and partners. The fact that we have always been so mission driven, with a clear conviction that our greatest asset is our people, has served as a solid foundation that has allowed us to continue to expand our business during these times. While our revenue growth rate continued to be impacted by the disruptions from the Covid pandemic in the second quarter, we're starting to get a clearer picture of the role that advertising is playing as markets reopen.

We talked last time about how data driven advertising would be on the front foot as that happens. And much as the global financial crisis of 2008 and 2009 caused many advertisers to consider data-driven strategies for the first time, I believe this crisis will cause advertisers to leverage data more aggressively than ever, as they look to make every ad dollar work as hard as possible. And we started to see this play out through our second quarter and into the start of the third.

Since ad spend troughed in mid-April, advertisers have been returning and reactivating campaigns, but most of them with new approaches and new creatives given the environment we're in.

They realize that as markets reopen, they have a unique opportunity to gain market share. Many paused in mid-to-late March and even early April, but some advertisers in all categories have seen this as an opportunity to gain share. To do that, they've had to be more flexible and agile than ever, as markets open in different ways, at different rates, even within the same country.

They are under pressure from their CFOs to prove the value of every advertising dollar, forcing them to prioritize advertising that is measurable and comparable. And they are dealing with a consumer base that is rapidly shifting away from traditional, linear TV.

All of this puts data-driven advertising in the front seat.

And we saw this reflected in our performance throughout the second quarter.

While we ended Q2 with a negative 12.9% year-over-year revenue decline, since April, we saw spend on our platform increase every month and nearly every consecutive week. As advertisers have been more deliberate, ad spend turned positive on a year-over year basis in mid-June. And that trend has continued through the month of July.

On a personal note, I was surprised at how unified the ad industry was in pausing activity starting in mid-March. We took a healthy economy, a healthy industry, and collectively hit the pause button. I'm not sure that sort of synchronized response has ever happened before.

At the same time, I was equally surprised at how unified the early phases of recovery have been so far. Not just that advertisers have returned in a consistent way, with a renewed focus on programmatic. In fact, nearly all of the largest brands have increased their spend on our platform. This includes spend from industries such as CPGs, food and beverage, technology, healthcare, and automotive. Even travel, while still negative year-over-year, has improved significantly off its mid-April lows. But its more than that. It's about the unified view I've heard from the market regarding the direction of the advertising industry. Over the last 4 months I have met with more executives at brands and agencies than ever before in such a short period of time.

So today I want to share some of that feedback with you, and in particular, the convergence of three forces that are shaping the world of digital advertising. I think this feedback will shed some light on our strategy and our performance and why we are well positioned for the future.

- The first is how the industry is coming to terms with user-generated content.
- The second is an important inflection point in CTV which is not unrelated to advertisers coming to terms with user-generated content.
- And lastly, I want to touch on the future of identity, because creating a solution that works for consumers, advertisers and publishers is the only way we'll be able to create a better internet.

So perhaps the most important area where I have seen a unified front from advertisers in the last few months is in their approach to user-generated content (or UGC). I use the term UGC deliberately, rather than social media platforms or video platforms like YouTube, because in my discussion with advertisers, it's the nature of the content rather than the platform that's the problem.

To quote Unilever, "there is much more to be done, especially in the areas of divisiveness and hate speech during this polarized election period in the U.S."

Or Diageo, "We strive to promote inclusion and diversity, including through our marketing programs…we will continue to discuss with media partners how they will deal with unacceptable content."

Or Starbucks, "we will continue discussions with our media partners and with civil-rights organizations in the effort to stop the spread of hate speech."

Pretty much every major brand has made public statements to the same effect. The statements were all made as they pulled or suspended advertising from the major platforms that are built around UGC.

The issue is not necessarily the platforms themselves. In fact, I think many advertisers believe those platforms are in a very tough spot, and I agree. The content on these platforms reflect the divisiveness in public discourse today, and that divisiveness is only exaggerated as people work through the implications of COVID-19, as social justice issues take center stage, and as we gear up for a major election.

Asking social media platforms to be the arbiter of truth on a range of divisive issues is a really tough ask. In some cases, such as with hate content, it might appear straightforward. But broadly speaking, it requires applying judgements, and when you're making judgements, you're always at risk of alienating someone.

It's an impossible task for UGC platforms to be asked to judge what is truth or what is hate, especially the largest companies, given the amount of content that is posted to their platforms every day. There is simply no way to keep up.

But for advertisers, increasingly, it's a risk they don't want to take. Brand safety is a critical issue. They don't want the divisive argument of the day, played out on social media, sponsored by their brand.

And I don't think this, in and of itself, is the wake-up call that advertisers were waiting for. I think it's the straw that breaks the camel's back. Advertisers have long had their doubts about advertising on UGC. But to date, it's been an easy way to reach an audience at scale.

But what these issues have highlighted is that advertisers have very little transparency and control when spending dollars on user generated content. They don't know exactly what content their ads will show up against, and they don't know which consumers have interacted with their brand. By contrast, advertisers increasingly understand that The Trade Desk provides the tools they need to buy only the premium inventory they want to support, and reach only the audiences they value. These conversations have accelerated considerably in the last few months, and we are winning spend from traditional video and social media plaforms as a result.

One second quarter example of this was a multi-national food and drink company that, through their global agency, began to think differently about how to allocate their digital ad spend and move it away from user-generated content. In this case, they chose The Trade Desk for two main reasons. One was the ability to apply measurement and offline attribution tools to understand exactly who they were reaching. The second was the tools and breadth of premium inventory on the platform for buying CTV instead of UGC.

Of course, the rapid emergence of CTV as a viable option is key here. For advertisers, access to a growing base of brand-safe, premium content could not contrast more with what is available today in user generated content.

Which brings me to my second point. The surge in CTV.

In Q2, despite the impact from Covid, CTV spend grew about 40% year over year. In Q3, we anticipate that the CTV spend growth rate will more than double Q2. We believe the Covid pandemic has permanently accelerated the growth of connected television, changing the TV landscape forever. And no company is better positioned to grab share in CTV than The Trade Desk.

As one leading CMO said to me a recently, and I quote, "I want to move as much budget from social to CTV as possible, as soon as possible."

And that's not an isolated comment. Advertisers are unified about this. They understand that data-driven advertising is a better place to measure performance and target key audiences. And now they can bring that approach to their massive TV ad campaigns. And it's not just their concerns about user generated content that are forcing this. There are two other major forces at work. One is the rapidly increasing inventory of premium CTV content. The other is the consumer shift toward CTV, accelerated by the COVID pandemic.

Let me quickly remind you what we discussed last time on our earnings call. Our research suggested that 11% of US households would cut the cable TV cord by the end of the year. That's about triple the rate of cord cutting that we've come to expect the last few years. That cord cutting rate rises to 18% for the coveted 18-34 year-old demo. And the number one reason households would keep cable TV? Live sports. 60% of them cited live sports as the primary reason they hang on to cable.

And you don't have to take my word for it. Fast-forward three months. ROKU recently issued its annual survey into TV viewing trends. According to their research, 32% of US households have now cut the cord or never had it, and a further 25% are "shaving" their cable TV costs. 45% of those cord shavers said they expect to fully cut the cord by year end. The number one reason? Cost savings. In the current environment, many households are looking at their home entertainment costs and their cable TV bill is often the most expensive part of their TV content line-up.

But related to that, the number 2 reason? Access to free streaming TV services. As more broadcasters make their content available through AVOD services, the cost equation for many households is something of a no brainer.

And according to the same survey, even if live sports make a comeback, less than one in five cord cutters said they'd rethink their decision. Because those same sports events are now available over streaming services.

So whatever assumptions you had about the shift toward CTV and how many years it would take – you can throw those out. COVID has changed everything.

Advertisers can't ignore these shifts in consumer behavior.

And they do not want to.

As I said, their growing concerns about user generated content, which are only exacerbated by recent events, represent the straw breaking the camel's back.

They want to shift to the premium content that CTV now enables. Their consumers are there. In addition, not only has NBC launched its new streaming service Peacock on July 15, but Pluto reported three times the viewing hours in April that it had at the beginning of the year. Tubi reported that their viewing hours were up 100% in April. Vudu reported an increase of 55% in this stay at home environment. Such is the growth in AVOD, that these platforms have recently been acquired by Viacom, Fox and NBCU respectively.

In addition to moving to where viewers are, advertisers also benefit from applying data to their TV campaigns for the first time. For example, after the Covid lockdown started, a large US insurance company wanted to be more data-driven in their TV spend. Their goal was to extend reach while managing frequency. Using a third-party measurement firm through our platform, the results were transformative. Even though CTV CPMs are roughly 3 times those of linear CPMs, using CTV lowered the cost-per-unique household by over 2.5X. Even more eye opening for the brand, using CTV on our platform, they were able to reduce ad frequency to the consumer by over 80% compared with their previous linear campaigns. In this case, site visits were 2X more efficient when using data-driven CTV versus publisher data. Overall, this resulted in a significant reduction in cost per acquisition.

As I see advertisers question the value of user generated content, and as they make CTV a more important element of their media mix, I also pick up a more unified sense from advertisers that they want to put more pressure on the industry to uphold certain standards.

One of the attractions of CTV is that it's a more competitive market than UGC, with the standards that typically come with competition. No studio, no channel, no cable company, no MVPD, no one company has the leverage or resources to achieve the market dominance enjoyed by Google in search and Facebook in social. And because we continue to predict video in all its forms will account for about half the trillion-dollar advertising market, we believe that CTV may well be the catalyst that eventually forces all walled gardens to change course.

It's important to remember that in the great scheme of things, the digital advertising industry is relatively young. As with any market that emerges, there comes a time when key participants demand certain market rules. Things like transparency and objectivity. And that's what I see happening now. CTV may be the most vivid example, but you can also look at how advertisers are now having to do more with less, how they are demanding better measurement transparency, and more market objectivity. You can even look at various regulatory initiatives within our industry, whether it's here in the US, or in Australia, or Europe. There's pressure on all fronts within the system to have the advertising market conform to the norms of other mature markets.

And as I speak with advertisers, they put the debate regarding the future of identity in that exact same context. Which is the third point I want to touch on today.

We can discuss the specifics of any one identity offering, and we are examining all of them, but at the core of it are two critical questions that advertisers and publishers think about:

- How do we explain the value exchange of the internet and the role of relevant advertising to consumers?
- How do we ensure power doesn't become too concentrated in one place?

The moves that Apple announced recently with IDFA represent a step forward. When a consumer logs in to an iOS app, they will be asked to opt-in to tracking in return for personalized ads. That's a partial step toward explaining the value exchange of the internet – the understanding that we get to enjoy premium content and experiences in return for relevant advertising.

Google is going through the same process. But the issue is complicated for them by the dominant position they enjoy in digital advertising. If they remove cookies from the Open Internet in Chrome and rely on proprietary logins for the advertising business which makes up almost their entire revenue stream, even if using privacy as a shield—it may be seen as an overreach by regulators. In dollars and sense, I don't think the risk is worth it to them. I expect that they will find a way to preserve relevant advertising for all of the reputable advertisers and advertising platforms in Chrome. Regardless, we have to prepare for a world without third party cookies. Fortunately, we've successfully launched and built a ubiquitous ID before – our Unified Open ID.

When we developed the first iteration of our Unified ID solution, the core idea was to make sure certain players, particularly Google, didn't have an unfair cookie coverage advantage over the rest of the internet, and particularly the open internet. This was a huge success as every major SSP and exchange has adopted this ID, which is more important than ever. As more advertisers embrace data-driven advertising, especially with the CTV surge, they want to ensure that the market is competitive and that they can compare one media property to another. That kind of measurement and comparability is key, and it's not possible within walled gardens.

Following the guidelines outlined by the IAB's Project Rearc, we've been focused on ensuring that the next phase of Unified ID will help empower the open internet beyond just cookies. Development is underway with a focus on a few core characteristics:

- First and most importantly we need an Open ID, which is a major upgrade over current cookie technology, and which will include a hashed and encrypted ID with improved accountability measures. Unlike a cookie, this ID does not live in the browser. This ID can be used in a browser or on any type of device, including a phone or a connected TV – and this ID will be free and open-sourced
- Second -- Granular and understandable consumer controls, with the option to opt-out

- Third -- A simplified consent framework for publishers, which explains the value exchange of content in exchange for relevant advertising for consumers
- And Fourth -- Single sign on capabilities across the open internet – so consumers don't have to consent over and over again.

We won't go this alone of course. As with our initial Unified ID solution, we will work with the industry to drive consensus and standards, and to ensure we build a solution that will drive the required critical mass of adoption. We're in development and we expect to have beta versions of this solution in market soon.

This work is important because cookies are an archaic technology that need to be upgraded. That said, I'm still not convinced that Google, in the end, will get rid of third-party cookies. And even if they do, cookies will be replaced with something else that enables targeted advertising. I do not believe that Google will have the ability to turn off targeted advertising for everyone but them.

As I said, advertisers and publishers are starting to demand the kinds of market rules for digital advertising that we've come to expect with other mature markets, such as financial markets.

Independence, objectivity, and auditable measurement are more important to advertisers than ever before. We're driven to maintain and build a free and open internet that honors the quid pro quo of the internet. We want an internet that is better for consumers as well as advertisers and publishers.

As advertisers commit more of their budgets to digital, especially as they shift more of their TV dollars to CTV, they want to know that they can reach the right audiences, that they can measure and compare performance, and that they can support the right content for them. The move toward a more contemporary approach to identity will be key in building that trust for advertisers.

Let me close by just reiterating the consistency of these themes among advertisers. If, like me, during COVID, you've been sucked into the world of online webinars and events, you'll have heard many of the same themes.

But I'm excited by it. Advertisers are more tuned in to the power of data-driven advertising than ever before. They understand the role it can play in helping them be agile in the midst of today's uncertainty. They understand it can help them gain market share. And as they embrace it across their advertising channels, they are demanding more of our industry.

This has been an important moment for The Trade Desk. 2020 is a moment where the culture we have built over the last decade is paying dividends, perhaps more than ever. Also, we have always been a company with a vision and a mission, and that has been more valuable in 2020 than any moment in our past.

And that's always been our approach. We've spent 10 years getting ready for this moment. While we still have a great deal of uncertainty in front of us, we're very excited about the future.

Now, let me turn the call over to Blake to discuss our financial performance.

Blake Grayson, CFO

Thank you and good afternoon everyone. I hope you're all doing as well as possible in this challenging environment. Before turning to results, I wanted to comment briefly on the status of our company's operations.

Today, we are currently operating with the majority of our full-time employees working from home. Safety is the number one priority for our team. We fully support our employees as they either continue to work from home or return to the office based on their preference and where allowed by local regulations, and in Q2 we were pleased to continue to onboard positive net new employees every month, investing in talent that we believe will deliver future value to our clients. Given the circumstances, I really can't say enough about the dedication, focus and professionalism with which The Trade Desk team is tackling the challenges presented during this period.

Now moving on to our results,

In Q2, revenue was $139.4 million representing a decline of 12.9% year-over-year. That said, however, the story that developed over the quarter was a positive one. Coming off the lows we experienced in mid-April, spending trends improved throughout the period and by mid-June turned positive on a year-over-year basis and that has continued into July. As we began to see those improvements, we started to increase the pace of our investments to further capitalize on the opportunity that is presenting itself in our business, particularly in CTV.

For Q2, despite the year-over-year revenue decline, we generated $14.6 million in adjusted EBITDA, or about 10.5% of revenue. With the investments we are making in our people and our solid working capital situation, we believe we are well positioned for future growth acceleration as conditions continue to improve.

From the channel perspective, Q2 included strong year-over-year spend growth, relatively speaking, in branded channels where advertisers can really connect with customers. Here Connected TV was up roughly 40% and audio was up 23% year-over-year in Q2. During the month of July we continue to see improvements across all of our channels.

Geographically in Q2, similar to last quarter, North America represented 88% percent of spend and International represented 12% of spend. Some of the spending trends that I mentioned earlier applied to our regions, as North America, APAC and Europe each improved every month during the quarter on a year-over-year basis.

In terms of our verticals that represent at least 1% of our spend, nearly every category improved between April and June, with many exhibiting strong resilience. In particular, Health & Fitness, our largest vertical in 2019, as well as Technology & Computing, Home and Garden, and Education continued to perform well. While still improving materially from their April lows, Travel and Automotive lagged behind – although in the last few weeks we have seen Automotive turn positive year-over-year and are encouraged about that.

We are actively working with large automotive companies and their agencies to activate more campaigns on the platform. Our early May CTV launch provided an opportunity to showcase our ability to deliver incremental reach, with frequency controls and measurement of real business outcomes. As a result, CTV represented a significant amount of these brands ad spend on our platform in Q2. We believe this represents a growing opportunity in the back half of 2020 and into next year.

Operating expenses were $155 million in Q2, up 21% year-over-year. This increase reflects continued investment across areas such as our technical talent and business development teams, but also being mindful of our cost structure in this environment and decelerated from 30% year-over-year growth in Q1. This approach to our operating expenses continues to reflect how we actively allocate capital within the company toward areas that can drive future growth. As spend started to recover we began allocating resources to incremental investments. Our goal is to invest heavily in the areas that can drive growth so we can grab share during the recovery.

Adjusted EBITDA was $14.6 million in Q2, representing a 10.5% margin.

Income tax was a benefit of $41 million in the quarter mainly due to the tax benefits associated with employee stock-based awards, the timing of which can be variable.

Adjusted Net income for the quarter was $44.8 million or $0.92 per fully diluted share.

Net cash provided by operating activities was $96.3 million for Q2 and free cash flow was $75.5 million. The primary driver for the increase was a change in working capital that can vary from quarter to quarter depending on the timing of payments and receivables.

DSOs exiting the quarter were 96 days, down six days from a year ago. DPOs were 74 days, down seven days from a year ago.

We exited Q2 with a strong cash and liquidity position. Our balance sheet had $555 million in cash, cash equivalents and short-term investments at the end of the quarter. I'd like to remind you that depending on the shape of the recovery curve, our liquidity position will fluctuate as we fund our growth.

I am going to use the remainder of the time today to discuss Q3 and how we are managing the company through the current environment. Like last quarter, we do not intend to provide financial guidance for the full year. However, we do want to provide direction for Q3. Please be aware, our business has been impacted by the COVID-19 pandemic that has significantly impacted advertiser demand. Like many companies that are ad-funded, we are facing a period of higher uncertainty in our business outlook. We expect our business performance could be impacted by issues beyond our control, such as shelter-in-place orders that may or may not occur. Assuming that the economy continues to open up and we do not have any major Covid related setbacks that may cause economic conditions to deteriorate, we estimate revenue growth in Q3 to increase 8 to 10 percent on a year-over-year basis. Under this assumption, we estimate adjusted EBITDA to be at least $30 million in Q3.

We also continue to be mindful of cash management, maintaining liquidity and investing in working capital as spend continues to increase. From an expense management perspective, while we are increasing our investments today, in light of the current environment, I want to remind you that we do have flexibility should things deteriorate. I'm proud of the agility we exhibited in Q2, and we have those levers, and additional ones depending on the environment, as needed.

However, we are certainly encouraged and remain motivated by the stabilization trend in spend we have seen since the middle of April. We believe we have the structure in place to accelerate growth and gain share as economic conditions improve and are cautiously optimistic about continued measured improvement through the remainder of the year.

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