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TRVG.OQ - Q2 2018 Trivago NV Earnings Call

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PRESENTATION

Operator

Good day, and welcome to the trivago Second Quarter Earnings 2018 Conference Call. Today's conference is being recorded.

At this time, I would like to turn the conference over to Matthias Tillmann, Head of Investor Relations. Please go ahead.

Matthias Tillmann - *trivago N.V. - Head of IR*

Thank you, Liza. Good morning, everybody. Welcome to trivago N.V.'s Financial Results Conference Call for the Second Quarter ended June 30, 2018. I'm pleased to be joined on the call today by Rolf Schromgens, trivago's CEO and Managing Director; and Axel Hefer, our CFO and Managing Director. The following discussion, including responses to your questions, reflect management views as of today, July 25, 2018, only. We do not undertake any obligation to update or revise this information.

As always, some of the statements made on today's call are forward-looking, typically preceded by words such as we expect, we believe, we anticipate or similar statements. Please refer to today's press release and the company's filings with the SEC for information about factors which could cause our actual results to differ materially from these forward-looking statements. You will find reconciliations of non-GAAP measures to the most comparable GAAP measures discussed today in our earnings release, which is posted on the company's IR website at ir.trivago.com. I encourage you to periodically visit our Investor Relations site for important content, including today's earnings release. Finally, unless otherwise stated, all comparisons on this call will be against our results with the comparable period of 2017.

With that, let me turn the call over to Rolf.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Yes. Welcome, everybody. Many thanks for joining our Q2 earnings call 2018. Last year has been very challenging for us. We grew at a very solid 67% in the first half of 2017 before we had to adapt to this new environment, which has been quite a test for the company. We are very happy with how our people dealt and continue to deal with it. We were truly -- but we also truly believe that we will come out stronger than before. About a year ago, we experienced a significant drop in our commercialization as our core asset prices adapted their performance targets. This means that we will see significantly less for every yield of booking volume that we generated for our asset prices. As a consequence, year-over-year comparison has been unfavorable for the past 4 quarters, including the current one. This effect will start to ease over the coming quarter as we loop the effect that I mentioned before.

But let's go first and look at the financial performance of the current quarter. Again, we compare it against a very strong quarter -- second quarter in 2017. Additionally, lower commercialization and foreign exchange rate headwinds negatively affected our performance in this period. As a consequence, total revenue declined from EUR 298.3 million in Q2 2017 to EUR 235 million in the second quarter of 2018. For the first half of 2018, this means a decline from EUR 565.9 million to EUR 494.4 million. The decline in revenue reflects a drop in QRs, qualified referrals, from 196.4 million to 177.1 million in Q2, which leads to a stable QR development in the first half 2018 compared to the same period in 2017. Revenue per qualified referral decreased from 100 -- from EUR 1.5 to EUR 1.3 in the second quarter and from EUR 1.5 to EUR 1.33 in the first half of 2018 compared to the same period in 2017, respectively. The geographical mix of revenue shifted again towards the rest of the world markets, which last quarter made about 24% of our overall revenues now. So these numbers are both a signal for us to adapt our strategy and, at the same time, they offer a reflection already of what we have done in the last month.

Looking at the high growth rates up until Q3 2017, one thing that's often forgotten. Before the IPO, trivago went only through a very small financing round, accumulating actually in total not more than EUR 1.4 million in venture capital. Yet we were always trying to maximize our growth potential, but at the same time, we also aimed to do this without being dependent on external funding. This is a vital part of our culture, being focused and being resourceful, always only spending what we earn. It was the basis for our core strength, optimizing our product and our marketing channels, becoming a little bit better every single day. That's how we remained at positive or close to positive EBITDA through all these years.

In the last 4 quarters, though, we widened our losses. After the margin dropped end of Q2, we tried to partly compensate for the losses in commercialization. We accepted them temporarily to keep our growth traction. In Q1 and the beginning of Q2, this reached a magnitude that we do not see in line with our culture that I described above anymore. As we cannot control the level of commercialization, we have to assume that the current levels are not temporary but reflect the current state of the marketplace. That's also a call for us to act and to go back to the legacy that made us successful.

Let me just summarize for you the different effects that you can see in our Q2 numbers. During the last year, we had to cope with the decline in commercialization. This led to lower revenue per qualified referral and a decrease in return on advertising spend. That's the first line that you can see on this slide. At the same time, we adapted our marketing attribution to focus on high-quality traffic. The second line that you see. This partly compensated the effect on revenue per qualified referral but at the same time led to a negative effect on qualified referrals also. Now over the course of the second quarter, we have raised our profitability targets through all our marketing channels with the aim to go back to profitability on a company level. As a result, we see further impact on qualified referrals, but we also see positive effect on return on advertising spend.

In the current quarter-over-quarter growth rates, you can already see the effects of this change. Revenue per qualified referral growth rate went down in line with what we have seen in previous years. We were able to largely compensate for the commercialization effects to improve traffic quality. Return on advertising spend has improved the development compared to 2017, which is a direct result of our new raised marketing targets. As a consequence of both, qualified referral growth came down.

Going deeper into the current quarter, you might be able to see the effect more clearly. You can see that we cut our marketing spend progressively throughout the month of the quarter. The decline in qualified referrals is, of course, also reflection of the strong comps we had compared to the same months 1 year ago. Additionally, they are a consequence of our increased traffic quality with higher booking conversion. But still, you also see a reaction to our new focus on profitability. The return on advertising spend improved significantly during the course of the quarter, and we are now seeing positive effects in the year-on-year comparison. We will continue on this path as we are very happy with the first results that we are seeing also in the current performance. Clearly, we aim to rebalance the business on a higher profitability level and start growing again after that.

Looking at our current advertisers, they are mixed and they're mixed in our marketplace. You also see positive developments. Compared to 2017, we remained a more balanced distribution that is now very stable for the last 2 quarters. We have currently very good discussions with our advertisers in how to develop the services for them and maximize the efficiency of the marketplace for everybody involved.

Let me now hand over, and we are open for your questions -- oh, sorry.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Okay. Thanks, Rolf. So let's look at the deeper end to the financial performance of the second quarter.

So in the second quarter, revenues came down by 21%, reaching EUR 235 million, while for the first half of the year, revenue came down 13%, reaching EUR 494.4 million. The adjusted EBITDA was at EUR 17.7 million negative in the second quarter 2018 compared to EUR 3.2 million positive last year. And that, as a percentage of total revenue, represented a minus 7.5% adjusted EBITDA margin versus a positive 1.1% last year. If you look at the return on advertisement spend, we had 113% last year in the second quarter, came down to 113% -- 110%, so a drop of 3 percentage points, while for the first half of the year, we reached 109% compared to 117% last year.

Looking at the KPIs globally. There are a couple of effects that are across the regions, and I would like to start with them first. The QRs were negatively affected by our continued focus on traffic quality at the sacrifice of quantity and our focus on profitability and more effective spending, leading to a reduction in QRs. Our RPQR were negatively impacted by year-on-year double-digit drop in commercialization and exchange rates of -- had a negative translation effect on this metric. Both effects were partially mitigated by the improved traffic quality that Rolf mentioned earlier. The ROAS suffered from the drop in commercialization, which has been mitigated by our focus on profitability as of the second half of this quarter.

Looking now at Developed Europe. Our qualified referrals came down from 82.1 million to 63.5 million in the second quarter. The first half, the drop was 155.7 million to 133.5 million. In the RPQRs, we managed to keep them basically flat from EUR 1.47 to EUR 1.46 through a strong improvement in traffic quality, and particularly in this region. For the first half, there is a slight decline from EUR 1.50 to EUR 1.48. Looking at the ROAS, we improved the profitability in Developed Europe for the total quarter, second quarter, from 124% to 127%, which is an increase of 3 percentage points. For the first half, we still saw a drop from 131% to 128%, so a 3% drop.

Looking at Americas. There was a 10% drop in qualified referrals, down to 46.9 million. In terms of RPQR, looking at RPQR in U.S. dollars, the drop in commercialization could not be compensated by the improved traffic quality, as we have seen it in Europe. So as a consequence, the RPQR in U.S. dollars dropped from $2.46 to $2.13 or by 13%. The ROAS in Americas dropped by 5 percentage points, reaching 112% in the second quarter, and by 9 percentage points, reaching 108% in the first half of the year.

Coming to Rest Of the World. We grew from 62.4 million qualified referrals in the second quarter of 2017 to 66.7 million in the second quarter 2018, which represents a 7% growth rate. On RPQRs in U.S. dollars, the improved traffic quality could not fully compensate the drop in commercialization, and as a consequence, the RPQR in U.S. dollars dropped from $1.04 to $0.97 or 7% in the second quarter. The ROAS came down from 92% in Q2 2017 to 87% in the second quarter of this year or by 5 percentage points.

Looking at our overhead costs. Our cost of revenue in the second quarter of 2017 were EUR 1.4 million, which came down to EUR 1.3 million in the same period of this year. The other selling and marketing expenses went up from EUR 14.3 million to EUR 16.7 million or 16.8%. The technology and content investment came up from 12% -- EUR 12 million to EUR 15.7 million or a 30.8%. And the G&A investments came up from EUR 9.2 million to EUR 12.2 million or 34.1%. Overall, our costs and expenses increased from EUR 36.8 million to EUR 45.9 million or 24.7%... If you look our headcount development, the increase that we've seen in 2017 and also in the first quarter 2018 has reverted. So we saw a drop from 1,620 employees to 1,566 employees. And we expect a stable to a slightly down headcount number in the second half of 2018.

Coming to the guidance for 2018, it is important to reiterate where we currently stand. After years of rapid growth, we have faced some challenges regarding the commercialization of our marketplace. Mid of last year, that still persists. Focusing on revenue growth historically and in the past few quarters at the expense of our profitability, we reached a level in Q1 2018 that we did not think was sustainable. As a consequence, we have decided to shift our focus towards profitability for the time being, which we started to implement around mid-quarter. We are so far happy with the results that our change in focus has resulted in and believe that we are on a good trajectory. We will only guide on adjusted EBITDA going forward, reflecting our change in focus.

Overall, our recent performance makes us more confident for 2018 than we were before, and therefore, we raise our adjusted EBITDA guidance. We now expect an adjusted EBITDA from minus EUR 15 million to minus EUR 30 million. On our other KPIs and P&L line items, we expect the following development year-over-year for the second half of 2018. Revenue is expected to be down in both quarters. Return on advertising spend is expected to be up with stronger profitability in the fourth quarter. Operational expenditure is expected to be flat in the second half of 2018 compared to '17 while we expect our headcount to be flat to slightly down going forward. Our RPQR is expected to decline slightly on a group level for both quarters going forward. To summarize, we're confident that we are taking the right actions to consolidate the business and adjust to the changed market environment.

Now I hand over to Rolf for the closing remarks.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Actually, we're now going for the questions, I think.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Okay.

Matthias Tillmann - *trivago N.V. - Head of IR*

We're now open for questions, I'm sorry.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Now we will take our first question from Douglas Anmuth from JPMorgan.

Douglas Till Anmuth - *JP Morgan Chase & Co, Research Division - MD*

Two, if I could. First, last quarter, you talked about a leg down in profitability targets from the larger OTAs in late 1Q. So I was just curious if you could give us an update there through the course of the quarter and if you're seeing anything different into the back half. And then second, can you tell us about any other ways that you're looking to drive traffic? Anything that might be different perhaps from your paid channel, that there's something you can do more organically or -- on a nonpaid front?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Okay. Let me start with the -- with your first question. There we've seen, since our last earnings call, stable dynamics in the marketplace. So there is no update.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

I think regarding the second question on new marketing channels, so I think we made a lot of improvement in all the performance marketing channels during the last year, focusing more on booking volume. That's -- and we see the results are coming in now. But regarding new traffic channels, we got more engaged into Google Hotel Ads. And this is -- we ramped this up during the second quarter, and we're seeing very nice positive results already.

Operator

Now we will take our next question from Naved Khan from SunTrust.

Naved Ahmad Khan - *SunTrust Robinson Humphrey, Inc., Research Division - Analyst*

It's Naved Khan, SunTrust. Just a quick clarification on your pullback in advertising. I guess you're pulling back on both brand as well as performance channels. In terms of just us trying to think about which one maybe you might be pulling back more on, how should we be thinking about it? Is it that you're pulling back more on performance? Or is it equal?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

No. I mean, we're looking at all the channels at the same time now. So we have been becoming way more profitable now in the performance channels over the last month, and the same is true for our brand marketing. So it's basically on the same level because -- I mean, there were specific levels of efficiency before that we thought makes sense. And I mean, basically, you try to optimize on all channels at the same time so you get basically to the same kind of potential cuts, more or less.

Naved Ahmad Khan - *SunTrust Robinson Humphrey, Inc., Research Division - Analyst*

Okay. And then just on the outlook. So revenue under the new outlook is going to be down year-on-year. Can you give us a sense of the magnitude? How should we be thinking about that? Should it be low single digits, mid to high? How should -- can you just give us more color there?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Yes. So we don't give any guidance for other metrics other than adjusted EBITDA, but it will be down. And I guess you have some data points in the first and second quarter, and the color that we gave for the monthly trajectory in the second quarter to get a sense what to expect.

Naved Ahmad Khan - *SunTrust Robinson Humphrey, Inc., Research Division - Analyst*

Okay. And then one last question, if I may. So other players in the online travel ecosystem have also been spending reasonably on TV. Do you see any impact on your own ROIs in that channel or not really? How should we kind of think about it ourselves?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

I mean, the TV market is obviously a very, very large market, and the impact of other travel players coming in and out doesn't have an impact on the pricing of the advertisement.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

And also doesn't have impact -- we don't see an impact on our returns. So I think it's still a super large market, and the effect on like one of the players growing on small percentage share of the overall market is not really impacting us a lot, yes. So we don't -- at least we cannot measure it. We cannot measure the effects on us.

Operator

And our next question comes from James Lee from Mizuho Securities.

James Lee - *Mizuho Securities USA LLC, Research Division - MD of Americas Research & Senior Internet Sector Analyst*

Couple of questions here. Any reason you guys involving Google Hotel Ads a little bit deeper this quarter? Are there any specific advantage for you for using this product, maybe, for example, you can bid by property, maybe one of the advantage there? And also, can you help us understand and see what kind of trends are you seeing in July specifically? Supposedly, Expedia will likely step up their spending in the back half as they expend a lot of inventory here in Europe? And are you seeing any activities there?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Okay. So on Google Hotel Ads, I mean, it's basically -- we have started to test in the channel some time ago, and the further we test, obviously, the further we scale the channel. And we -- in the second quarter, we were just at a point in our testing where we could significantly scale it up, in particular, in the U.S., which is a very large market. And that's why it is the first quarter where it has a noticeable impact. But it is more driven by our pace of testing and scaling up rather than the market environment.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

And regarding the trends in July, I think Axel said that before, that we see a quite stable marketplace environment so there's no general update. We see that all our advertisers are very engaged. They want to work with us. We don't see yet any advertiser like stepping up, spending more, being more aggressive. So that's, at least, something that we can, right now, not see, no?

James Lee - *Mizuho Securities USA LLC, Research Division - MD of Americas Research & Senior Internet Sector Analyst*

Okay. If I add -- can add a follow-up question here. Looks like ROAS in Europe has improved a little bit, and Americas and Rest of World is declining. Can you help us understand what you're doing right in Europe specifically and what you need to do specifically in Americas and also in Rest of World for that ROAS to move in the right direction?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Yes. It's more -- I think it's more a timing of our measures that you can see there. So the drop in QRs was a bit stronger in Developed Europe as well. So we are just improving our targets quicker, and we're able to implement that more quickly than in the other regions relatively speaking to last year. So there's no fundamental difference. It's just a timing and in the year-over-year comparison.

Operator

And our next question is from Mark May from Citi.

Mark Alan May - *Citigroup Inc, Research Division - Director and Senior Analyst*

I had a couple of questions related to RPQR. In -- it's been down only kind of low single digits in Developed Europe the last few quarters. It's actually been trending up in Americas for the last couple of quarters. In your prepared remarks, however, you mentioned that, "We continue to experience lower levels of commercialization." Was that comment in the prepared remarks just related to year-on-year? Or are you seeing it on a go-forward basis? Because you don't necessarily see it in the numbers themselves. The last couple of quarters, it's been relatively stable in your major markets.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Yes. So the RPQR rating has -- I mean, in euro terms, has really the 3 effects that come out in the different regions slightly differently. So there is a double-digit year-over-year drop in commercialization. So that's -- we made the last -- the same comment in Q1 2018. So that's definitely a drag for all the regions. And then we've got -- we have counter effect, that is the improved focus on traffic quality, which, on the year-over-year, has a different effect in the different regions. I guess you compare it to 2 different areas, so with different quality starting points and improvements there. And then obviously, you have for the U.S. and for Rest of the World, you've got the currency effect in the second quarter, which is slightly different to the first quarter. And that's why you come out basically flat in Europe and slight negative in Americas and in Rest of the World. As you look at it overall, including the mix effect of the different regions, we think that the -- for the whole company, the RPQR will be slightly down, adding up all these effects in the year-over-year comp and the mix effect between the 2 regions.

Mark Alan May - *Citigroup Inc, Research Division - Director and Senior Analyst*

But forgetting the year-on-year, just from a sequential perspective, RPQR seems to be relatively stable. Is that kind of your expectation?

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

So what happens is the RPQR is very dependent on traffic quality, no? So basically, of course, like you have -- you have like a -- if you have a higher traffic quality coming in, you would expect the RPQR to go up, no? So -- and so it was very highly dependent from traffic quality. What we did during the last year in parallel was we shifted our marketing, before, we had our marketing focusing on the revenue that we generated. Now our complete -- our marketing is completely focused on the booking value that we generate. So we -- that's why we, today, buy way more qualitative traffic than we bought 1 year ago. And that leads to the effect that we have now, less traffic but with a higher quality, and that drives RPQR up. And so -- and that compensates for the effect of -- on the other side that we have a dip in commercialization. So these effects balance out. We know it's super hard to see in the numbers, but these 2 effects always balance out.

Mark Alan May - *Citigroup Inc, Research Division - Director and Senior Analyst*

Got it. And final related question. In the second half, starting now, you're going to be even more focused on efficient marketing spend and traffic quality. So should we expect to see an even more meaningful improvement in RPQR?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

On -- I mean, the focus on profitability, I think, mainly has an impact on the return on advertisement spend and then obviously on the QRs now because we are more targeted on the profitable spend. On the RPQR, the -- if you look at the year-over-year comps, we implemented the attribution model in the end of July last year. So -- and then gradually over the 3 quarters, Q3, Q4, Q1, then in SEM. So there is, indeed, the comp effect. There is definitely still a positive effect coming from the increased focus on quality. But it is coming down over time, yes. So I think that's what to keep in mind when modeling the next couple of quarters.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

I think the difference of these 2 effects is -- just let me say that the difference of these 2 effects is that until today, basically, we shifted basically to higher traffic quality. What you see right now is that we raised now on the few standards. We raised our overall targets. So that's just a different effect. That doesn't ultimately mean that just due to that, that the RPQR would go up, no? It's different than the last 4 quarters, yes.

Operator

And our next question is from Brian Nowak from Morgan Stanley.

Brian Thomas Nowak - *Morgan Stanley, Research Division - Research Analyst*

I have 2 just a couple of big-picture questions. The first one, on the long-term top line growth, Rolf, can you just talk to sort of 1 or 2 strategies or areas where you see for potential improvement to drive faster referral growth? And then secondly, on the top line, how should we think about how long it could take the attribution model to really drive a material impact on revenue per qualified referral? And then I know you're making a lot of great changes to the business model and sort of rethinking about growth. In the past, you've talked about long-term profitability and targets. How do you think now about sort of the long-term profitability or margin profile of the business in the new regime?

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

So let me answer on the strategies to drive growth. So I think if you're looking back at trivago like how we managed the business, it's not this silver bullet where we say, okay, we go this direction and then there will be more growth. So what we constantly do is the improving our product, we're improving our marketing channels, we constantly get -- gain more efficiency in the product, in the marketing channels. And that's the way how we've grown the business to the point where it is today. So there was often the past there was no with no silver bullet. There was really like very analytical like understanding of the marketing channels, going deep into the numbers, understanding and improving, and that is actually ongoing. So I know that it's always hard to see in the numbers. But if you compare it and compare the level where we are today, having in mind the challenges that we had to face last year, this improvement is still, underneath, going and happening. And we think that now on the new profitability level, this will also drive the growth in the future. And we're seeing it also right now, also, if you're not seeing it in the numbers. So -- and we think, right now, we had a year where we had to cope with the situation. I think the next upcoming quarters will be also us rebalancing the business, becoming more profitable and then, from a profitable base, start growing again. But right now, we took the decision to say, okay, we want to step in and we want to become more profitable first.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Okay. Coming to your second question, the impact of the attribution rollout, I mean, we see that in the RPQR already. I mean, so the reason why we are basically flat in the RPQR despite the double-digit drop in commercialization is both the product focus on more booking conversion and it's also the focus in marketing through the attribution model. So I think the positive effect, we're seeing there already. And as I said before, I mean, on the DA channel in the year-over-year, it's basically fully ended. Has been a year since we really launched it there. For SEM, we really rolled it out more gradually over 3 quarters. So there is still some effect in the year-over-year that will come out of it, but it has been quite some time since we rolled it out. So the positive effects are there and we can see them, and they support already the RPQR. On your third question, the long-term profitability target is, from our perspective, not changed. So we still think that 25% adjusted EBITDA margin is a margin that we can achieve in the long term. So there's not really an update on that number from our perspective.

Operator

And our next question is from Peter Stabler from Wells Fargo Securities.

Peter Coleman Stabler - *Wells Fargo Securities, LLC, Research Division - Director & Senior Analyst*

A couple for me, if I may. In the past, when you've talked about the HotelDirect opportunity, you've typically referred to it as a long-term project. Wondering if you could revisit what the primary obstacles are for you in building that channel. trivago's got pretty tremendous exposure. I mean, your advertising spend is down, but I think most of us would agree it's still a high visibility brand. So not sure it would be awareness, but would love to hear some additional input on that, what are the primary obstacles. And then a follow-on to that would be, did the launch of Google Hotel Ads and the improvement in that product, does that represent an incremental and significant competitive threat to you guys long term in terms of building the HotelDirect revenue channel?

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Okay. So on the HotelDirect -- okay. So on your first question, on...

(technical difficulty)

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

There's an echo.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Okay. Starting with your first question on HotelDirect, the way we are approaching it is that we've got this 3-step conversion funnel. So we've got the free-to-use product, which is our Hotel Manager, which more than 400,000 hotels are using, and we've got a paid product that is by more than 40,000 hotels, which is giving them a lot more access to data. And then the ultimate step is to get them directly on our platform. So when you look at that funnel, I mean, the biggest obstacle, actually, between step 2 and 3 is not so much having the access to the customer or to the hotel, which we have already, but it's also the technical connection that the hotel has. So there, the hotels need to have certain technical infrastructure in place to directly connect to us, and that takes some time and also some effort from the hotel. And it's similar to -- for a lot of these hotels. I mean, they've got no online presence, all they just have one online presence through one OTA. To go from one OTA to own websites to multiple OTAs require some investment, and that is really what makes it more long-term opportunity. So it's not only in our control how well we actually sell and how convincing we are in communicating our value proposition, but at the same time, it's a development in the market for more and more hotels investing into their technology and their connectivity. So that's really, I guess, what makes it more our mid- to long-term project. On the hotels that we have access to already that are connected, it is obviously -- it is something that is more under our control, and that has more short-term, midterm impact. On Google Hotel Ads, the way -- I guess what you need to keep in mind is Google Hotel Ads is used by a user at the choice of Google. So Google decides how much visibility the product is getting, which is very different to our usage, because our usage a user needs to decide to come to our site. So one is a conscious decision, and the other one is partially influenced by a tool that you use anyhow. So just the sheer size of the channel, for all respect, is not a good proxy of the competitiveness from a user perspective. And the channel has been growing in the past. But us now having access to that channel, we think, is an opportunity for us because they are a significant pool of traffic that we, in the past, didn't have access to, which was a disadvantage. So up to the point where we are represented equally in that channel in all our large markets, we see it as an opportunity. But overall, it's clear that Google and Google Hotel Ads is, from a user perspective, one of our direct competitors.

Operator

And our next question is from Tom White.

Thomas Cauthorn White - *D.A. Davidson & Co., Research Division - Research Analyst*

Just one more on RPQR. In Europe, it was basically flat. You guys talked about the improvement in traffic quality. I guess on the traffic quality improvements, is that something that we can expect to have a more pronounced impact on RPQR in the other regions? Is it just a question of sort of timing when you kind of rolled out those initiatives? Or is there something structural that maybe means that Europe kind of sees the bulk of the benefits from traffic quality? And then just another sort of follow-up on kind of HotelDirect. I guess I'm just kind of curious to hear your views on revenue diversification in general. Is that a big focus area for you? I'm wondering kind of other products maybe that you guys might be thinking about or either new ad formats just to kind of expand your base of advertisers a bit. Curious to hear your thoughts there.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Yes. So on your first question on the stable RPQRs in Developed Europe versus the drop in the other regions, I mean, the way to think about it is that just the measures that we implemented to improve traffic quality had, in the year-over-year, a stronger impact on Europe. And as a consequence, the QRs dropped stronger and the traffic quality went up more. So -- but that doesn't mean that Developed Europe is basically a frontrunner in the trend for the other regions. I think it is more specific to the region and the traffic mix that we had there last year versus what then resulted in a different impact of the initiatives that we launched. So I guess it's better to look at it region-by-region rather than from inferring from the development in one region to something that will happen in other regions.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Yes. Thanks for the question regarding revenue diversification. No, we're not planning to go in other services. We're not planning to go into other verticals. So we really want to build the best hotel search that is out there, and we don't think that we have done that so far. So we can do way better than we do right now. So there's a huge potential for the company to do this better and to create like a great value in the market, and that's what we want to go for. And we do whatever is necessary to do so, and HotelDirect is one of the opportunities we have there to create a better hotel search because we want that the consumer has a choice to go to any OTA but also, at the same time, go to a HotelDirect and have the chance to book directly with the hotel. And on the other side, we also want to offer individual hotels the chance to compete on their property with the global OTAs, and that is to create a better hotel search. And that's why we're going into that direction, but we're not planning to go into other directions.

Thomas Cauthorn White - *D.A. Davidson & Co., Research Division - Research Analyst*

Okay. Just one follow-up on that. So no new products or new verticals, but what about kind of new ad formats for kind of the core hotel vertical? One of your competitors is obviously experimenting with kind of more kind of sponsored media type ad units to try and kind of diversify their advertiser base a bit. Is that...

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Indirect -- I don't think that it will go in the direction that you are thinking about. So I think we have tested around different display opportunities for our hotels in the past, and we will also do so in the future. But there will be no kind of like sponsored placements or something like that, for example.

Operator

And then our next question comes from Lloyd Walmsley from Deutsche Bank.

Unidentified Analyst

This is [Chris] on for Lloyd. So it sounds like you guys aren't going to be moving into any new verticals within the space, even though you have a lot of some of the other online travel platforms moving into areas like attractions. So just really as it relates to the brand or to your direct traffic, how do you increase your mix of direct traffic going forward if you're not going to be moving into any of these new verticals?

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

We improve it in the same way that we improved it in the past. So you could have asked this question 5 years ago, and you would have gotten the same answer and we were like a fraction of the size that we are today. So we think this is a super huge market. We're having only -- we're having a small change a bit. The market is still going more and more from off-line to online. So we currently don't see that there is like a limitation in the market size and that we have a limitation to grow in this market. And if you then -- if you get to a limitation, then we can think about going into other verticals. But right now, it's rather about how can we improve our product. And I think companies like booking.com have shown that over the last year like how large the market is and with being just in one vertical. And of course, now they are thinking about like diversifying. But we are not yet the size of booking.com. If we are the size, then we can, of course, think about it.

Operator

And our next question is from Kevin Kopelman from Coleman -- from, sorry, Cowen and Company.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - Director and Senior Research Analyst*

So when you look at the actions that you took to increase your profit focus, do you consider those fully implemented as of June? Or did you make additional cuts to your ad spend in July?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

So do we consider it to be fully implemented? I guess the strategy is implemented, and I guess what the strategy means is that we are challenging every dollar we spend and set to the higher profitability targets. So that will not stop in July, but it's obviously dynamic, yes? So yes -- so I think we will see further improvements coming out of it, but we might adjust or we'll adjust the targets continuously to what we see in the market.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Yes, I think the question is -- do you ask is was it implemented for the full June? Definitely not, yes, it's -- because it happened also during June. Was it implemented beginning of July, I also don't think that in other -- we were everywhere across-the-board there where we wanted to be. So I think there's still an effect of in July. And because, of course, like when you're looking at performance marketing channels, you have -- you cannot just jump from -- in profitability. You have to adapt the profitability targets step-by-step.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Perhaps just to add to that. On the TV side, you have -- you obviously also have commitments. So that obviously where you have less flexibility, and that's why I said we will basically challenge every spend that is coming up new. So it will be, yes, a continuing process.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - Director and Senior Research Analyst*

Yes. And then another timing question, which is how do you think about the comps for Q3 and Q4? Do you see them as easing? And do we have to wait until October until you see that somewhat easing in your results? Or does it happen sooner than that? Of course, it's only a partial comp, but thanks.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

So the comps in the second half of the year are significantly easier than the first half of the year, and so that's definitely the case. Whether they are easing from the third to the fourth quarter, I mean, we -- if you remember, last year in October, we gave some color on the marketplace dynamics at that point in time. But that's a bit intra-quarter, yes? So there are definitely effects last year that have an impact on the year-over-year comps. But yes, I mean, it's not to the same amount or degree that we saw in the first half '17 versus first half '18.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - Director and Senior Research Analyst*

And then -- so on the ad, the changes to your sort of ROAS or strategies on spend, do you see it as you had sort of this change in the environment and you're temporarily sustaining losses and then you kind of adjusted your ROAS targets for that? Or are you looking at bigger changes that are -- that actually puts you in a place that is different than when we go back like a year or more?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Yes. So I think there are basically, I mean, 2 effects that have an impact on your question, one is the market environment. And if your commercialization drops double digit, obviously, that is structurally taking out, in the comparison, profitability out of you, and so you need to compensate for that. But overall, when we say for the time being, we focus on profitability, that is a different focus than last year and the year before, where, actually, our focus was on revenue development. So I think those are the 2 components to consider where we're heading.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - Director and Senior Research Analyst*

Yes. And then one last question, if I can. So in the past, you targeted about a 50-50 mix between TV ads and performance spend. And as of your most recent changes, where do you see that mix?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Yes. So as Rolf said to the -- earlier, so the optimization is across all the channels. So we still think that the basic mix of roughly 50-50 is the right mix. But...

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

But we want to say that we don't have to manage for the mix, no? So I mean, this is rather an outcome than it's a variable that we want to achieve. So we go for profitability goals, and everything else is an outcome. So it's not something that we actively manage.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Yes.

Kevin Campbell Kopelman - *Cowen and Company, LLC, Research Division - Director and Senior Research Analyst*

Is it still looking like around 50-50?

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

We didn't disclose that. We think that is probably the right mix, yes.

Operator

And then our next question is from Shyam Patil from Susquehanna.

Brendan McGoldrick - *Susquehanna Financial Group, LLLP, Research Division - Associate*

This is Brendan on for Shyam. Just 2 quick ones. Just first on alternative accommodations. Can you guys update us on sort of your progress there and when you expect it to potentially have a noticeable impact on the business? And then what are like the -- some of the hurdles or things you need to sort out for you to do so? And then just on competition, you guys have kind of addressed this already in different pieces, different questions. But can you share any thoughts on bookings, recent ramp up in metasearch acquisitions and sort of Google's more targeted efforts in the metasearch space, kind of what impact you've seen or expect to see from those 2?

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Sure. So let me start with your first question on our increased

visibility of alternative accommodation. I mean, since we launched the HomeAway integration in November, we were very clear that we are gradually increasing the visibility and, at the same time, testing through the various parts of the business to make sure that the change in inventory mix doesn't have a negative impact on our existing core business. And we are on track with increasing that visibility. So we are now at 800,000-plus items or accommodations that we consider alternative accommodation. And there are already destinations where it is very significant. But we continue to believe that it is very important to stay disciplined and not rush it and gradually increase visibility to make sure that all the different components of the business ecosystem are digesting the change in inventory mix.

Axel Hefer - *trivago N.V. - CFO, MD of Finance, Legal & International and Member of Management Board*

Yes. I think to the second question regarding competition, Bcom acquiring HotelsCombined. So I think first of all, it's a sign that Bcom believes in meta. So I think they have the best visibility in the market, and they have the best visibility on the business model. So they seem to believe into the business model, and I think that is also like a good sign for us. And in total, I think also looking at what Google is doing, so I think, in general, seeing that competitive, like Booking, like Google, often move into our direction. It's just like also confirming us that we are moving in the right direction. But -- and still we have to compete and be better. And I think at the end of all that, it's all about the product, are you able to improve your product faster than your competition. And clearly, we have Google as a competitor, but we have Google as a competitor also I think already for the last, let me devise, 8 years, 9 years or so. So -- and I think we have done pretty well, and we keep on improving the product, and we want to be the best metasearch or the best hotel search.

Operator

It appears that there's no further questions at this time. I would like to turn the conference back to you, Rolf, for any closing or additional remarks.

Rolf Theo Johannes Schrömgens - *trivago N.V. - Founder, CEO, MD of Product, People & Culture and Member of Management Board*

Yes, thanks a lot. So many thanks for joining the call. The last 4 quarters were challenging for us. We had to adapt to the new environment. And let me really say I'm super thankful of how our people in trivago reacted to it. They have seen the necessity to ask and to adapt, but they also stay true to our culture and to our beliefs, which is equally important.

In total, I see this last year as a development that brought us, I think, again closer to our core, to our core beliefs and also closer to what we want to be in the future. I think now, we really have to take these learnings that we made in the last year and build upon the first positive signs that we now see. Our clear goal is to rebalance the business on a higher profitability level and start growing after that.

Thanks a lot for joining the call, and goodbye.

Operator

This concludes today's conference call. Thank you for your participation. You may now disconnect.
