Buy The Trade Desk

Karl Thiel | May 24, 2017 | Buy Recommendation

CURRENT PRICE: TTD $ 409.71 ↑ $ 13.34 (3.4%)

This is the second time we've recommended The Trade Desk! *When we re-recommend a stock, it's a sign of extra confidence in a company we already know well. While we don't advocate buying too much of any stock, we think you should give this one a longer look as you build a well-diversified portfolio of 15 or more stocks to own for at least three to five years.*

I want to tell you a little secret about Rick Munarriz, who first co-recommended **The Trade Desk** (NASDAQ: TTD) with me in February: He's not just the dedicated analyst you see here at *Rule Breakers*. He moonlights as a water-park enthusiast with a well-known Web site dedicated to breaking down the good and bad of parks across the country. His site has been successful enough to attract some advertising revenue over the years. But the truth is, advertisers are hardly knocking down Rick's door.

I bring this up not to toot Rick's horn, but to show how many ways there are to advertise in the world. Even your *RB* analysts have ad space. There are literally of *millions* of digital channels hoping to attract ad dollars. Everything from major media channels on the Web and TV to niche sites and blogs like Rick's are vying for a slice of the pie.

With those kinds of numbers, you can see why machines are doing more and more ad buying — there's simply too much going on for humans to make sense of. Making data-based choices on where to place ads, bidding on inventory, and then adapting as campaigns unfold is going to be slow-moving guesswork if it's left to us. Most auctions take place in real time, in a fraction of a second, as you wait for content to load on a Web page or TV screen.

Now consider that the Trade Desk's platform was allowing users to automate bidding on 5.7 million ad spots *per second* in the first quarter. And by the end of the year, it expects to be handling 600 billion ad queries every day. That's why we're so excited to recommend this fast-rising company again, just three months after we first did. There's a lot of ad money looking to be spent — and we think investors will end up with plenty of their own.

A Good Start, With More to Come

The obvious need to run big data through smart algorithms has led to a lot of competition in the programmatic ad business. But most companies are focusing on sellers, or trying to address the market as a whole. The Trade Desk exclusively serves ad buyers, and that is a hidden key to success. As Rick can tell you, the real power in this industry lies with the agencies and large companies managing campaigns. They control the budgets, and they offer the lasting relationships.

The Trade Desk has gotten off to a smashing start for investors who bought the last time we recommended it — up 50% in just three months. That gain has largely come thanks to a powerhouse first-quarter report

WHAT IT DOES

The Trade Desk operates a self-service software platform that allows ad buyers to purchase and manage advertising campaigns across thousands of different channels.

WHY YOU SHOULD BUY

- The Trade Desk is taking share, growing 5 times faster than the robust programmatic ad market.
- The company is attracting new clients to its platform even as existing customers spend more.
- Founder and CEO Jeff Green still owns 17% of the company, aligning his interests with ours.

KEY DATA

- **Headquarters:** Ventura, Calif.
- **Website:** investors.thetradedesk.com
- **Sign of a Breaker:** Smart Management
- **Market Cap:** $2.0 billion
- **Cash/Debt:** $107 million / $26 million
- **Revenue (TTM):** $226 million
- **Earnings (TTM):** $26 million
- **Revenue (2014/'15/'16):** $45 million / $114 million / $203 million
- **Earnings (2014/'15/'16):** $0 / $16 million / $21 million
- **Recent Price:** $52.51

BUYER'S GUIDE

- **Industry:** Software
- **Size:** Small Cap
- **Region:** Global
- **Risk:** 10 out of 25 (see all our stocks here)
- **Crushability:** Jawbreaker (see the full scale here)
- **Most similar to:** Alphabet, Facebook, Salesforce.com

where, as founder and CEO Jeff Green put it, "nearly everything went right."

That could be a lucky confluence of events that will be hard to repeat in the future. But here's why we're more excited than ever: Green said that most of the surprise upside the company saw during the quarter came from new agencies and brands joining the platform. Client retention has consistently been above 95%, so we can reasonably expect these new customers to stick around. Moreover, they'll increase their spending over time. That was certainly the case in 2016, when existing clients increased their gross spend across the platform by 71%.

Customers are increasing their spend with The Trade Desk because more advertising is going programmatic all the time. Right now, the figure is around $19 billion annually, which is a mere sliver of the $650 billion global advertising pie. The Trade Desk is looking to gobble up more of that pie by adding more tools to address huge markets like Internet TV. On top of that, The Trade Desk is poaching business from its rivals. It grew nearly 5 times faster than the programmatic ad market in the first quarter, indicating that it's aggressively taking market share. Agencies don't have to use The Trade Desk exclusively, but they may start moving in that direction nonetheless.

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Financial data from S&P Global Market Intelligence.

Data as of May 22, 2017

LOOKING FOR THE 5 AND 3?

Look for our glance at the five green flags and three red flags we're watching for in the coming weeks!

This is obviously a more expensive stock than it was in February, but I still believe it's reasonably priced for the opportunity ahead of it. Management now expects revenue to grow, at the midpoint of estimates, 44% this year. The company also boosted its margin outlook, and despite planning on some heavy investment this year that will tamp down profits, it now expects earnings before interest, taxes, depreciation, and amortization (EBITDA) of around $78 million for 2017. That means the company is trading at less than 26 times this year's estimated EBITDA. That's hardly cheap, but it compares favorably to other cloud-based service companies such as **Salesforce.com** (NYSE: CRM), **Veeva Systems** (NYSE: VEEV), or **Zendesk** (NYSE: ZEN) that aren't growing as quickly ... not to mention the bulk of its competitors that aren't profitable at all. It's a fair price to pay for a company growing this quickly, with this long a runway.

Risks and When We'd Sell

The main risks I see for The Trade Desk haven't changed much since February. Chief among them: The ad business is changing so quickly that it's hard to predict the twists and turns that might emerge in the coming years. The Trade Desk's buy-side focus looks like the sweet spot right now, but its clients are likely to keep experimenting with rival platforms and strategies. The disruptor could be disrupted, or at least more effectively imitated.

The Foolish Bottom Line

The Trade Desk has the DNA of a winner, something we've already seen during its short tenure on our scorecard. It offers a differentiated platform that's disruptive, but ultimately offers to benefit buyers, sellers, and consumers. In that sense, it's a little like **Zillow** (NASDAQ: ZG). While it doesn't threaten incumbents in quite the way Zillow did, it is similarly creating a win-win platform by offering transparency over an older business model that profited from inefficiency.

Not to be underestimated in its list of winning attributes is Green himself. He's a pioneer in the field, having created the first digital ad exchange, which he subsequently sold to **Microsoft** (NASDAQ: MSFT). And Green isn't just aligning his company's interests with those of its clients; he's also aligned his interests with ours by maintaining a 17% stake in the company. Don't be put off by the quick spike in The Trade Desk's stock price — I think patient investors will be rewarded.

Get all our updates on The Trade Desk:

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Teresa Kersten is an employee of LinkedIn and is a member of The Motley Fool's board of directors. LinkedIn is owned by Microsoft. Aaron Bush owns shares of Zillow Group (A shares) and Zillow Group (C shares). David Gardner owns shares of Zendesk and Zillow Group (C shares). David Kretzmann owns shares of Veeva Systems, Zillow Group (A shares), and Zillow Group (C shares). Rick Munarriz owns shares of Microsoft. Tim Beyers owns shares of Salesforce.com. Tom Gardner owns shares of Zillow Group (A shares) and Zillow Group (C shares). The Motley Fool owns shares of Veeva Systems, Zillow Group (A shares), and Zillow Group (C shares).

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