

Buy The Trade Desk

Karl Thiel and Rick Munarriz | February 22, 2017 | [Buy Recommendation](#)

CURRENT PRICE: [TTD](#) \$ 409.71 ↑ \$ 13.34 (3.4%) 📈

Invest Foolishly! *We recommend owning 15 or more stocks for at least three to five years. Begin with three [Starter Stocks](#). Once you're under way, then consider our monthly new ideas to help build out your Rule Breakers portfolio.*

If you watched the TV series *Mad Men*, you probably have some image of how ad buying used to work. Leaving aside the extracurricular activities, it was relatively straightforward, because there was a limited number of predictable channels: three major television networks, local radio, and popular magazines and newspapers.

Today, there are millions of places we might see advertisements. Moreover, the best match-up between brands and likely buyers varies by product and individual, and it changes over time. This isn't a job for martini-fisted guys in a smoky room; it's a matter for Big Data, artificial intelligence, and lightning-fast response time.

Over the past few years, programmatic ad buying has emerged as the hottest way to maximize ad spend. It began with the emergence of ad exchanges that put together bidders with the multitude of publishers selling space, then evolved into real-time, automated bidding platforms. Our recommendation this month, **The Trade Desk** ([NASDAQ: TTD](#)), has taken this business to the next level. Its software cannot only dig through masses of data to select optimal channels of advertising, but it can also pinpoint shifting dynamics and adapt campaigns on the fly.

Instead of advertising basketball shoes to everyone who watches a March Madness game, advertisers can give extra impressions to someone who also visits basketball websites, focusing even more on the prospects who've actually browsed for shoes online. Moreover, because Trade Desk's omnichannel approach integrates media buyers' data, it can better measure consumer actions and act on them. You've probably had the experience of buying something online, only to have it aggressively advertised to you for weeks after the fact. That's one reason why Trade Desk co-founder and CEO Jeff Green says "advertisers are literally spending billions of dollars to make the consumers hate them." His company has some Rule Breaking ideas for solving that problem, and we think shareholders will benefit in the process.

Get With the Program

There's a lot of work to be done. The estimated \$650 billion spent globally on ads in 2016 was still more *Mad Men* than Silicon Valley. According to market consulting firm Magna Global, only about \$19 billion of that huge sum was programmatic. There's little doubt that this figure will rise much higher.

The Trade Desk isn't the only company looking to facilitate the shift. In 2013 and 2014, a slew of ad-tech companies went public, pursuing various takes on programmatic ad buying. Indeed, we recommended

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 BUY

- One of the pioneers of programmatic ad buying, The Trade Desk is well positioned in a rapidly growing field.
- The company has avoided the mistakes of its rivals, aligning itself with the ad agencies it serves.
- The Trade Desk is already profitable and revenue is growing quickly, while the company's scale should improve with size.

KEY DATA

- **Headquarters:** Ventura, Calif.
- **Website:** [www.thetradedesk.com](#)
- **Sign of a Breaker:** Smart Management
- **Market Cap:** \$1.3 billion
- **Cash/Debt:** \$133 million / \$26 million
- **Revenue (TTM):** \$203 million
- **Earnings (TTM):** \$21 million
- **Revenue (2014/'15):** \$46 million / \$114 million
- **Earnings (2014/'15):** \$0 / \$16 million
- **Recent Price:** \$32.41

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

Follow TTD

TubeMogul ([NASDAQ: TUBE](#)) in 2015 on the basis of its algorithm-driven ad purchasing. It ended up a losing investment for us, a fate many of the others have shared. Yet The Trade Desk differs from TubeMogul and most of its other competitors in some critical ways:

Talk About TTD

Financial data from S&P Global Market Intelligence.

Data as of Feb. 17, 2017

- **It works with ad agencies, not companies looking to place ads.** By not turning the industry's top players into competitors, The Trade Desk has become a favored partner to some of them, like WPP, **Omnicom Group** ([NYSE: OMC](#)), and **Publicis Groupe** ([NASDAQOTH: PUBGY](#)). As a result, clients often integrate their proprietary data into The Trade Desk's platform, allowing them to capture insights that would otherwise be hidden.
- **It doesn't buy ad inventory.** Many ad-tech companies make money on arbitrage, essentially front-running the market and then selling off whatever inventory they have in stock. In contrast to what's often criticized as a "black box" model, The Trade Desk remains an entirely neutral, transparent platform for buying ad inventory in real time. That aligns its interests with its clients'.
- **It isn't an online-only platform.** The Trade Desk isn't just helping advertisers figure out where to place display ads. The company has made a large commitment to television, which it sees as a huge, largely untapped opportunity for programmatic ad buying. (**Netflix** ([NASDAQ: NFLX](#)) CFO David Wells sits on the board.) Its omnichannel approach means advertisers can gear a dynamic campaign across display ads, video, television, audio, mobile, and apps. Display ads made up less than half its revenue last year.

Landing the Big Accounts

The success of this approach has shown up in a high client retention rate — over 95% for 2015 and 2016. It has also shown up in the financials.

The Trade Desk just reported its fourth-quarter results, and 2016 revenue rose 78% to \$202.9 million, with \$75 million in operating cash flow. Clients spent more than \$1 billion across its platform last year, putting the company's "take rate" (revenue as a percentage of gross spend) at nearly 20% — an impressive figure that shows how much value the company is adding. This year, it's expecting revenue of "at least" \$270 million — much better than what Wall Street was expecting — with a take rate well over 18%.

We believe the company can maintain at least a 25% annual top-line growth rate over the next five years, thanks to the rising tide of programmatic ad spending and the company's early pursuit of channels beyond display ads. It's also likely to keep taking share from rivals, and it's been particularly aggressive in expanding internationally.

That scenario puts revenue on track to more than triple in five years' time, but the bottom line should be more exciting. Because this is a self-service software platform, it should scale as the company grows. While profits probably won't budge much in 2017 due to investment, even a 20x multiple on a steady-state net margin of 15% would put the stock nearly 50% higher than it is today. Given that the company's operating margin is already over 28%, we think that's a lowball estimate.

Risks and When We'd Sell

Wall Street has been tough on ad-tech companies. There were eight ad-tech IPOs from June 2013 to July 2014, and almost all of them have fared poorly. Stocks of **Tremor Video** ([NYSE: TRMR](#)), **Rocket Fuel** ([NASDAQ: FUEL](#)), **MaxPoint Interactive** ([NYSE: MXPT](#)), **Marin Software** ([NYSE: MRIN](#)), and **YuMe** ([NYSE: YUME](#)) have been savaged; Millennial Media was bought by AOL at a fraction of its initial valuation; and we had our own subpar experience with TubeMogul before it was acquired by **Adobe Systems** ([NASDAQ: ADBE](#)). Other companies have scrapped or delayed IPO plans.

The Trade Desk's differentiated model, sound financials, and close alliance with the world's largest ad agencies will secure it a far different fate, we believe. Indeed, Wall Street's recent distaste for ad tech has kept a lid on valuations — something that could reward shareholders as the company continues to perform well. Still, it's worth noting that one of the many reasons these companies have struggled is margin pressure, a natural outcome of so much competition. Right now, The Trade Desk boasts impressive margins, but we'll be keeping a close eye on its take rate to see whether it can continue to deliver value that commands premium pricing.

Ultimately, this industry is changing rapidly, and will continue to produce winners and losers. We think The Trade Desk is firmly in the former category, but with so much disruption taking place, we may see unexpected changes over the next few years that change our calculus.

The Foolish Bottom Line

Today's ad world would be almost unrecognizable to the executives of years past — Don Draper would probably need a stiff drink just thinking about it. Anyone who has ever seen an ad narrowly targeted to their interests knows the role technology is playing in this evolution. Now The Trade Desk is disrupting the disruptors. Founded by industry veterans and linked closely to the incentives of ad buyers, it's sidestepping the mistakes of its competitors and throwing off cash. Its best advertisement may be itself.

Was your time reading this recommendation well spent?

Yes

No



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