PUBMATIC Q1 2023 EARNINGS CALL: PREPARED REMARKS

SAFE HARBOR

A copy of our press release can be found on our website at investors.pubmatic.com.

I would like to remind participants that during this call, management will make forward-looking statements, including without limitation, statements regarding our future performance, market opportunity, growth strategy and financial outlook.

Forward-looking statements are based on our current expectations and assumptions regarding our business, the economy and other future conditions. These forward-looking statements are subject to inherent risks, uncertainties and changes in circumstances that are difficult to predict. You can find more information about these risks, uncertainties and other factors in our reports filed from time to time with the Securities and Exchange Commission, including our most recent Form 10-K and any subsequent filings on Forms 10- Q or 8-K, which are on file with the Securities and Exchange Commission and are available at investors.pubmatic.com.

Our actual results may differ materially from those contemplated by the forward-looking statements. We caution you therefore against relying on any of these forward-looking statements. All information discussed today is as of May 9th, 2023 and we do not intend, and undertake no obligation, to update any forward-looking statement, whether as a result of new information, future developments or otherwise, except as may be required by law.

In addition, today's discussion will include references to certain non-GAAP financial measures, including Adjusted EBITDA and Non-GAAP Net Income. These non-GAAP measures are presented for supplemental informational purposes only and should not be considered a substitute for financial information presented in accordance with GAAP. A reconciliation of these measures to the most directly comparable GAAP measures is available in our press release.

And now, I will turn the call over to Rajeev

CEO REMARKS

Thank you, Stacie, and good afternoon everyone.

Our focused strategy, strong execution, and deep customer relationships drove revenue in the quarter significantly above expectations. Underscoring the strength of our model and our continued focus on efficiency and infrastructure optimization, the majority of incremental revenue dropped to the bottom line, driving stronger than expected Adjusted EBITDA, net income and free cash flow. Our results reinforce the value of our platform, our ability to manage through the current environment, and how we are positioned to continue to capture market share despite the economic uncertainty.

While we saw sequential improvement through the quarter, it's too early to say if the ad spend environment has troughed, and whether the pronounced uptick we saw in March will continue. We therefore remain cautious with respect to our outlook and investment decisions. A key element of our strategy is to leverage our business model and strong degree of profitability to make targeted investments that position us for outsized market share gains when ad spend growth re-accelerates.

We believe the current environment is accelerating consolidation in our industry and will benefit companies like PubMatic that are global, scaled and profitable. Macro pressures have driven publishers to prioritize their highest-margin revenue streams such as programmatic advertising and increase their reliance on global, omnichannel technology providers to manage a greater portion of their ad tech stacks. The pace of new publisher agreements remains strong - we signed over 65 new publishers in the first quarter. We now have nearly 1700 publishers and app developer customers, up 14% from a year ago.

We expect to grow our roster of customers and increase stickiness with them in this environment.

OMNICHANNEL VIDEO (CONNECTED TV AND ONLINE VIDEO)

This is particularly true for our omnichannel video segment, which is a key growth driver. The omnichannel video market is expected to be a $215 billion market this year. A subset of omnichannel video, CTV is expected to be a $65 billion market this year. Publishers are increasingly adopting programmatic monetization strategies in order to tap into growing ad budgets that they previously were not accessing. As a result, our CTV revenue was up over 50% year-over-year in Q1.

We are accelerating the pace of new business growth in CTV. We saw a 10% increase in our CTV publisher customer base over Q4 to 237 publishers. Driving this is the growing recognition within the media and advertising industry of the advantages of programmatic CTV. Automated transactions are more efficient and data-driven than traditional buying methods, delivering higher ROI to advertisers and revenue gains to publishers. PubMatic has been a leader in providing programmatic technology for more than a decade and we have seen this trend playout time and again across formats and channels. I believe that we will look back on this period as the turning point that structurally changed the nature of CTV advertising towards more programmatic monetization.

At the same time, we are growing our existing relationships with premium streaming content providers as we provide the ability to both monetize their inventory and leverage their valuable first-party data. For instance, PubMatic helped A+E Networks grow its programmatic business by passing valuable data in the bidstream such as content genre and channel, making it easier for advertisers to reach their target audiences across A+E's properties and drive campaign ROI.

We recently expanded our partnership with iQIYI, one of the largest online entertainment companies in China, who implemented our OpenWrap OTT unified bidding technology to provide global advertisers more efficient and effective access to the company's streaming inventory.

The breadth of our publisher base makes us a scaled provider in the CTV market. We are working with six of the top seven global smart TV providers that have ad-supported streaming services, four of the top eight major addressable broadcast video on demand streaming platforms in the US and five of the top eight free ad supported TV streamers in the US. We also work with all of the top five addressable broadcast video on demand platforms in both Australia and Japan, two of APAC's largest CTV markets.

OPENWRAP

We are seeing OpenWrap, our Prebid-based wrapper solution, drive increased stickiness for publishers across channels and formats. Originally launched in 2016, over the last few years we have diligently broadened the footprint of OpenWrap to cover all leading ad formats and platforms including CTV, mobile app, and web, as well as video, display, and soon-to-be-launched native making us one of only a few scaled providers with a comprehensive, Prebid-based software solution across all major formats and channels.

Over the last several quarters, we have seen a surge in adoption of our wrapper solution as publishers increasingly abandon their homegrown Prebid wrappers or alternative solutions for PubMatic's OpenWrap. OpenWrap is now a critical component of publishers' ad tech stacks and central to their operations teams. Overall, signed OpenWrap agreements grew 27% YoY for Q1 as more publishers opt for the performance benefits and customer service PubMatic provides.

In the case of online car shopping site Edmunds, although they already had a header bidding solution, they were seeking an alternative that could give them more control over their yield management. After switching to OpenWrap, they not only saw an average eCPM uplift of 35%, but also identified that the trusted header bidding expertise of the PubMatic team was critical to their success.

GROWTH IN SUPPLY PATH OPTIMIZATION

We also continue to deepen our buy-side relationships, where consolidation is most evident as agencies and advertisers lean into scaled and transparent technology providers that can help them increase operational efficiency and innovation.

Supply Path Optimization expanded throughout Q1 and represented over 35% of activity. We have been able to leverage our profitability to deepen buy-side relationships, investing in our team and technology to offer a single integrated platform that delivers value to our customers. Plus, as we anticipated, the macro environment has been an accelerant for SPO, as major advertisers and agencies seek to improve return on ad spend and streamline their operations.

Our existing SPO buyers continue to consolidate more of their business on PubMatic. Five of the six global agency holding companies grew their SPO spend with PubMatic by 20% or more sequentially from February to March. Even with the significant gains we have made in SPO, we see a long runway of growth ahead. In the past quarter alone, we have seen an over 80% increase in buyers interested in engaging in SPO with PubMatic for the first time and now have an active pipeline of several dozen buyers. Long term, we believe there are hundreds if not thousands of buyers that we could engage in SPO with globally.

The consolidation we've seen across our industry has resulted in the rapid evolution of the advertising supply chain and we believe the industry is at an inflection point. It's becoming increasingly difficult for publishers and buyers to stay ahead of the curve, requiring significant investment and expertise. As such, we have focused our innovation investments in two areas, both of which expand our addressable market and will create durable long-term growth – Supply Path Optimization and commerce media.

SUPPLY PATH OPTIMIZATION & ACTIVATE

Yesterday, we announced Activate, an SPO solution that we have been working towards over the past 18 months and which leverages our recent acquisition of Martin. Activate is an end-to-end SPO solution that enables buyers to execute non-bidded direct deals on PubMatic's platform, accessing CTV and premium video inventory at scale and unlocking unique demand for our publishers.

This ground-breaking solution introduces a new industry paradigm for the supply chain of the future. PubMatic has taken an infrastructure-driven approach to solving some of the industry's biggest challenges that, historically, have prevented billions of dollars of insertion orders from entering the programmatic ecosystem. Our single layer technology approach does away with data leakage, discrepancies, multiple hops in the supply chain, opacity, and high aggregate fees associated with having multiple technology providers like SSPs and DSPs. In 2023, approximately $35B, or almost 60%, of CTV spend is expected to be transacted via IOs. Direct IOs also account for more than $27B, or approximately 18%, of online video spend. By providing a path to bring these direct dollars to programmatic, Activate represents a nearly $65B expansion of our total addressable market.

With Activate, our SPO solutions become even stickier. We expect buyers who use Activate will benefit from greater control over their supply chain and increased ROI; publishers will benefit from increased revenue.

Over the last few months, as we have engaged with prospective Activate customers, I've been blown away by the magnitude of interest in the solution, which validates our vision and roadmap as well as PubMatic's market position as a partner of choice. We have seen strong interest among agencies, advertisers and publishers in every major region and across verticals and buyer size, including global advertiser Mars, agency holding companies dentsu, Havas Media Group, GroupM and Omnicom Media Group Germany, and CTV publishers Fubo and LG.

As a key launch partner for Activate, GroupM is further expanding its SPO relationship with PubMatic. The GroupM Premium Marketplace, an initiative that provides GroupM clients with direct, transparent and efficient access to CTV and online video inventory, is built on PubMatic technology and will now extend to Activate. With Activate, GroupM clients can buy GroupM Premium Marketplace inventory on a guaranteed basis in a more efficient and direct manner, with less costs involved in the supply chain. It is also an opportunity for them to bring clients who heavily rely on direct IOs into the programmatic ecosystem. As a result, GroupM intends to improve their clients' working media and ultimately generate better outcomes.

To be clear, Activate is not a Demand Side Platform. Our industry already has a number of scaled DSPs. PubMatic is not offering a bidder, bid optimization, creative optimization, or a variety of other services that are core to the value proposition of a DSP. As I mentioned, Activate is specifically designed to transition non-programmatic insertion orders for CTV and online video into non-bidded programmatic buying transactions. PubMatic already has a strong foundation in programmatic guaranteed (PG) and private marketplace (PMP) deals, and Activate further expands this opportunity.

For PubMatic, we expect to see significant strategic and financial benefits, including Activate being a catalyst for faster CTV and online video growth over the medium term as well as an accelerated mix shift toward more premium omnichannel video formats, resulting in higher gross and net margins. Activate also facilitates greater stickiness with buyers which increases revenue visibility, and greater stickiness with publishers – allowing them to access unique ad dollars only available via the PubMatic platform.

GROWTH OPPORTUNITY IN COMMERCE MEDIA

As we bring more advertiser spend to our platform, we are also unlocking opportunities to further scale other areas of our business, such as retail or commerce media. Commerce media expands on the retail media opportunity set to include not just retailers but a wide variety of transaction-based businesses like transportation or food delivery providers, travel and event providers, fintech companies, and more.

We continue to grow our existing customers like Kroger Precision Marketing, providing the technology and solutions to enable them to activate their retail audiences across PubMatic's CTV, video and display inventory. We are also growing our footprint with additional commerce businesses that have high transaction volumes and valuable data. Over the past quarter, we've had several new customer wins such as Lyft and Tripadvisor, who are using our growing suite of onsite monetization solutions to help grow their commerce media businesses.

This is a tremendous growth opportunity for us, with an estimated market size of more than $120 billion. Data access and control are key areas of importance for commerce media, both areas where PubMatic already has market leading solutions. In addition, we have the financial profile to make focused investments in technology that specifically aligns to current and future commerce media needs, such as audience extension, on-site multi format monetization, and operational efficiencies to help commerce media companies scale their businesses further.

Operating under a similar playbook as we did with SPO – making focused investments that lead to market expansion and high revenue growth – we believe our strategy around commerce media will have similar returns. I look forward to sharing more with you in the coming quarters.

CONCLUSION

Our execution over the course of the quarter reinforces the value of the PubMatic platform within the digital advertising ecosystem and our ability to continue to consolidate the market as advertisers seek alternatives to the walled gardens. We are rapidly growing the platform with new publishers and buyers and creating greater stickiness with existing customers. Our omnichannel platform, global scale and strong financial profile are key differentiators and enable us to rapidly expand our addressable market. We will continue to prioritize long-term growth opportunities through highly focused investment, which we believe will drive outsized market share gains and greater shareholder returns.

I'll now turn the call over to Steve for the operational and financial details.

CFO REMARKS

Thank you Rajeev and welcome everyone.

Revenue in the first quarter was $55.4 million, above guidance and plus 2% on top of last year's growth rate of 25%. Importantly, year-over-year results improved each month through the quarter.

With our focus on execution and efficiency, the majority of our revenue outperformance dropped to the bottom line. Adjusted EBITDA was $8.4 million, or 15.1% margin. We also continued our long track record of cash generation with $12.8 million in net cash from operating activities and $5.3 million in free cash flow.

Against a backdrop of challenging macro conditions, we delivered against the core objectives we laid out last quarter:

1. deepening our publisher and buyer relationships,
2. driving omnichannel revenues,
3. achieving incremental efficiencies from our owned and operated infrastructure and
4. investing in high value product innovation.

REVENUE

As I mentioned on our last call, January revenues started off slowly, particularly in display and online video but we saw sequential improvements into February. Trends further improved into March across all our key formats and channels.

For the quarter, revenues from omnichannel video, which span across desktop, mobile, and CTV devices, represented approximately 30% of total revenues and grew 13% year-over-year. Within this category, CTV revenues increased by over 50% year-over-year.

As anticipated, display revenues, comprised of mobile and desktop channels, continued to be soft throughout the first quarter but showed monthly sequential improvement, and came in slightly better than expected at minus 7.5% vs. Q1 last year. This was an improvement over Q4.

From a regional perspective, EMEA continued its strong performance throughout the quarter and grew double digits year-over-year. Americas' revenues were down less than 1% compared to Q1 2022 and improved each month in the quarter.

Sticky customer relationships drove healthy multi-year net dollar retention rates. On a trailing twelve-month basis, publisher net dollar retention was 105%.

As a result of our global go-to-market efforts and targeted investments, we continued to expand our supply path optimization relationships which accelerated to over 35% of total activity on the platform.

Similar to our publisher strategy, once we land new SPO relationships, our Ad Solutions team works closely with buyers on detailed growth plans across formats and geographies. Viewed through the same retention lens as publishers, the net spend retention rate for SPO buyers with at least three years of spending was 116% on a trailing twelve-month basis.

Our ad vertical diversification again proved to be a valuable asset for us in Q1. Food & Drink, Health & Fitness, and Travel in aggregate, increased over 30% year-over-year. This growth helped offset declines in Technology, Arts & Entertainment and Hobbies. The Shopping and Personal Finance verticals ended the quarter in line with Q1 last year. In total, our top 10 ad verticals grew year-over-year.

OPERATIONAL STRENGTH

Overall, our business is in excellent shape. For an extended period of time, our strategy, execution, and global scale has enabled us to deliver positive adjusted EBITDA for 28 consecutive quarters. We have also generated cash from operations every year for 9 straight years. And since going public in December 2020, we have generated over $90 million of free cash flow.

With our long-term focus on profitability and cash flow, we take a nimble approach to managing our business. We have put in place multiple initiatives to drive productivity across our teams and lower operating costs. For example, we have realigned our global customer success team to ensure appropriate support relative to customer needs and business opportunity by market. This effort is supported by a specialized client team based in India.

Over the long run, our owned and operated infrastructure has allowed us to achieve significant operating leverage and control, which consistently delivers efficiencies for us and great outcomes for our customers. With this control, we are proactively managing our capex lower in 2023, beyond what we originally planned. Our optimization efforts are already ahead of schedule, and we anticipate improved gross margins later this year and next.

In Q1, we processed over 46.5 trillion impressions on our platform, an increase of 43% year-over-year. On a trailing twelve-month basis, we reduced our unit costs by 16% year-over-year. In addition to our capacity optimization work that is expanding total throughput, we are also making progress in using this capacity for the highest value display and video impressions. Taking our various optimizations and positive mix trends together, we anticipate lower capex spend in 2024 relative to revenue growth.

Our Q1 gross margin was 57%, ahead of expectations. As a reminder, our cost of revenue includes depreciation from prior year capacity build out and third-party hosting costs, which are largely fixed in the near term. We anticipate improving gross margins each quarter through the calendar year.

OPERATING EXPENSES

Q1 GAAP opex was $42.2 million or 32% increase year-over-year. Included in this total were incremental costs of $2.8 million related to our Martin acquisition and $2.5 million related to our January in person global sales conference. Excluding these incremental costs, operating expenses increased 15% year-over-year.

NET INCOME

GAAP net loss was $(5.9) million or -11% net margin.

Q1 Non-GAAP net income, which adjusts for unrealized (gain) or loss on equity investments, stock-based compensation expense, acquisition-related and other expenses, and related adjustments for income taxes, was $0.9 million or 2% of revenue.

Q1 diluted EPS was $(0.11) and Non-GAAP diluted EPS was $0.02.

BALANCE SHEET AND CASH

Turning to cash, we ended the quarter with $173.2 million in cash and marketable securities and no debt. We generated $12.8 million in cash from operations and $5.3 million in free cash flow. Our consistent cash generation enables us to invest in key areas for long-term growth and market share gains.

As of April 30th we have repurchased 1.1 million shares of our Class A common stock for $15.4 million in cash. We have approximately $60 million remaining in the repurchase program. Given our strong balance sheet, we are actively using our capital to significantly expand our addressable market, deepen customer relationships and drive market share gains. We believe this capital allocation strategy, coupled with our repurchase program, will drive long-term shareholder value.

FINANCIAL OUTLOOK

Now turning to our outlook.

The sequential month over month revenue improvements we saw in the first quarter were positive signs, but we remain cautious about the next couple of quarters. Macro conditions continue to be challenging and advertisers remain cautious. Arguably new sources of uncertainty have entered the picture that may impact consumer spending such as US Fed interest rate plans, the growing perception that inflation is stickier than expected and the effect of tightening credit conditions related to debt ceiling discussions and US banking system concerns.

Our April results reflected stable, positive year-over-year trends as well as indicators of ongoing macro challenges. On the positive side, impressions for CTV, online video and display were all higher year-over-year, ranging from double digit to single digit percentage increases. However the extended macro pressure since mid 2022 has been gradually pushing CPMs down. In April, omnichannel video CPMs were down mid-single digits year-over-year. Overall, CTV revenues were higher, while online video and display revenues were down. The net effect was that our April revenues were roughly flat year-over-year.

With the step down in CPMs compared to last year, we see continued revenue pressure in Q2 and are anticipating online video and display revenues will decline in the single digits while CTV will grow in the double digits.

In light of our overall revenue mix, with both positive trends and continuing headwinds, we anticipate Q2 revenue will grow sequentially from Q1 and be in the range of $58 to $61 million.

Our view on the market rate of growth for calendar year 2023 and our ability to continue to grow market share remains unchanged from last quarter.

On the cost side, as we had outlined in our prior earnings call, we have been taking actions to drive incremental productivity across every aspect of our business. For example, we are well on our way to adding approximately 20% incremental processing capacity by the end of Q2, without a corresponding step-up in capex.

Accordingly, as compared to 2022, we expect GAAP cost of revenues to increase at a slower sequential rate each quarter, in the low single digits. With capacity optimizations, continued strong execution and seasonal revenue increases, we expect second half gross margins to return above 60%.

We expect Q2 GAAP opex to decline by about $1 million compared to Q1 followed by sequential quarterly increases in the low single digit percentages thereafter.

Given our revenue guidance and our optimized cost structure, we expect Q2 adjusted EBITDA will grow significantly from Q1 and be between $13 and $15 million or approximately 23% margin at the midpoint.

We expect profitability to improve as the year progresses driven by the full effect of our cost reductions, optimizations and typical seasonal increases in ad spend. We anticipate Q3 and Q4 adjusted EBITDA margin levels to be above 30%.

For the full year, we expect adjusted EBITDA margin to be over 30%.

Turning to capex, as a result of capacity optimizations and operational efforts to drive higher value impressions onto our platform, we are lowering our expected investments this year to $12 to $15 million, more than 60% lower than 2022. These initiatives and others in the pipeline will enable us to incrementally increase free cash flow over time.

IN CLOSING

In summary, our strong execution in the quarter demonstrated our ability to operate successfully within this macro environment. We are on track to drive long-term growth, expand our market share and increase shareholder value. As a result of our durable business model, we anticipate:

1. Generating free cash flow on par with 2022
2. Delivering margin expansion for the balance of 2023 and beyond, and
3. Positioning PubMatic for revenue acceleration when ad spend stabilizes – by fostering deeper customer relationships, focusing on high-growth omnichannel revenues and launching new products – like Activate - that incrementally expand our total addressable market.

With that, I'll turn the call over to Stacie for Q&A.