PUBMATIC Q2 2021 EARNINGS CALL: PREPARED REMARKS

SAFE HARBOR

Thank you, operator, and good afternoon, everyone. Thank you for joining us on PubMatic's earnings call for the second quarter ended June 30, 2021.

Joining me on the call are Rajeev Goel, co-founder and CEO; and Steve Pantelick, CFO. Today's prepared remarks have been recorded after which Rajeev and Steve will host live Q&A. A copy of our press release can be found on our website at http://investors.pubmatic.com/.

Before we start, I would like to remind participants that during this call, management will make forward looking statements, including without limitation, statements regarding our future performance, 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. Additional information will also be set forth in our Quarterly Report on Form 10-Q for the quarter ended June 30, 2021.

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 August 10, 2021, 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. 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 and welcome everyone. We delivered another great quarter with performance well above our guidance as we benefited from a differentiated business model, multiple growth drivers, prior period investments, and accelerated digital ad spend.

Revenue in the second quarter grew 88% year over year to $49.7 million. Our over-performance on revenue contributed to increased profitability as well. Net income in the quarter was $9.9 million or 20% of revenue, and adjusted EBITDA was $18.6 million or 37% of revenue.

As we head into the second half of the year, we are well ahead of where we expected to be in terms of organic market share gains and revenue run-rate. Our strong execution and improving revenue visibility give us the confidence to raise our expectations. We now expect full year 2021 revenue growth of approximately 38% to 40% and Adjusted EBITDA margin of approximately 30% to 32%. This momentum, coupled with the success we're seeing from growth initiatives such as our rapid acceleration in CTV and the runway in front of us with Supply Path Optimization, gives us confidence in our 2022 revenue growth expectations of 25%, consistent with where we see our longer-term trajectory.

CURRENT MARKET ENVIRONMENT

The digital advertising industry is constantly evolving, creating significant opportunities for accelerated growth. Disparities are widening between the independent, omnichannel scale leaders like PubMatic and others who are conflicted because of media ownership or lacking in omnichannel scale.

Additionally, the market continues to consolidate, driven by Supply Path Optimization, regulatory and privacy requirements, and expectations for high quality inventory. The need to stay ahead of the market has never been greater and requires meaningful capital investment in product innovation and global infrastructure. Our profitable business model ensures that we can continue to innovate, expand capacity, and increase our value proposition to better serve our customers and capture market share.

We maintain the belief that the pandemic has pulled forward multiple years of consumer behavioral change. Digital ad spend is rapidly increasing and gaining share of the total advertising pie. At the same time, media consumption is in a high degree of flux between mobile, desktop, and connected TV devices. As the economic re-opening continues to evolve globally with some markets opening up while others continue or return to lockdown, we are in a strong position to be physically present with the consumer however they are interacting with media and advertising given our omnichannel and unitary platform, making us increasingly relevant for both our publisher and buy-side customers.

To take advantage of these trends, we are making significant investments given the multitude of growth opportunities in front of us. In the last six months, we have increased our headcount by nearly 14%, with a focus on driving revenues and platform innovation. To further support our growth, we have increased our impression capacity by 19% since January of this year. With greater momentum and visibility into topline growth, we plan to further invest for the remainder of 2021 and into next year, significantly increasing headcount and impression capacity.

GAINING MARKET SHARE

As a leading sell-side platform, we continued to outpace market growth across the board in Connected TV, mobile app, mobile web, and online video, with revenue growth sharply ahead of the market. The foundational element driving our market share gains is our infrastructure-driven approach to digital advertising. This infrastructure-driven approach serves as a flywheel that allows us to grow top line revenue, leverage our largely fixed cost structure to drive profitability, and re-invest in innovation on behalf of our customers to again drive top line revenue. Importantly, our omnichannel platform is a single, unified platform which allows us to be extremely nimble with respect to innovation.

On top of our unique infrastructure advantage, there are three key areas of market share gains that we are executing against:

- We continue to be a strong beneficiary of Supply Path Optimization due to the efficiency and transparency that our platform provides.
- We are growing rapidly in the fastest growing segments of digital advertising. In Q2, combined mobile and omnichannel video revenues grew by 108% year-over-year and represented a greater proportion of the total business. Our CTV business accelerated even further, which I will detail shortly.
- And the multi-year investments we have made, and continue to make, in audience addressability are paying off.

Let me dive a bit deeper into each of these three areas.

INCREASED REVENUE VISIBILITY FROM SUPPLY PATH OPTIMIZATION

A growing portion of our business comes from supply path optimization, or SPO agreements. In the second quarter, 23.6% of our total company ad spend was via these SPO agreements.

For PubMatic, SPO serves as a competitive moat, with the opportunity to shift meaningful market share to us over time. As buyers consolidate ad budgets onto fewer sell-side platforms, they gain greater efficiency, innovation, inventory quality and transparency which in turn allows them to achieve greater return on their advertising investments. As buyers commit an increased share of their ad spend to our platform, we gain greater visibility into future revenue and our publishers see increased revenue from PubMatic. As a result, we benefit from a high net dollar-based retention rate. In the second quarter, this metric grew to 150% on a trailing twelve-month basis.

We believe we have a distinct advantage in closing and ramping SPO deals because we own and operate our own infrastructure and we have a single, unified platform. This results in our ability to rapidly and efficiently innovate at omnichannel and global scale.

In Q2, we partnered with leading advertisers and agencies including Dentsu's Global Accredited Partner Program and IPG Matterkind Australia, resulting in greater spend from these agencies on our platform. Omnicom Media Group in The Netherlands also recently consolidated spend on PubMatic to help advance innovation across the agency.

ACCELERATING GROWTH IN OTT/CTV

Last year we launched our OTT/CTV solution. We built the solution for not only where the market is today, but where we believe the market is heading – transparent and efficient, auction-based ad transactions. Although the market shift from linear TV to OTT/CTV formats is still early days, we're very pleased with the rapid adoption and results we're seeing. Our solution supports biddable and fixed price private marketplace deals as well as open market transactions, and our growth metrics speak to the traction we are seeing in market.

As a reminder, OTT refers to over the top streaming content which can be streamed to connected TV or CTV devices, mobile devices, and laptop or desktop devices.

In the second quarter, OTT revenue inclusive of CTV, grew by more than 100% over Q1, a significant increase over the 55% sequential growth we saw from Q4 2020 to Q1 2021. As of the end of the second quarter, we are monetizing inventory from 114 publishers, up from 80-plus just a quarter ago. We now work with a wide variety of CTV and OTT partners, like original equipment manufacturer Xiaomi and virtual multichannel distributor Philo.

Critically, leading CTV ad buyers such as The Trade Desk are expanding their activity on our platform via programmatic transactions, consistent with our vision of the future of CTV, where advertisers can realize greater ROI via data-driven precision. Similarly, we have completed an integration with Google that enables PubMatic's CTV inventory to be accessed on-demand in the DV360 TV Marketplace. These partnerships validate our approach to the rapidly growing CTV market and together, they provide our publishers with scaled CTV demand from our two largest Demand Side Platforms.

GROWING TRACTION OF AUDIENCE ADDRESSABILITY PORTFOLIO

Innovation is a key component of PubMatic's DNA. Early on, we made the strategic decision to invest in a portfolio of solutions to lead the industry transition of audience addressability on the Open Internet. Several years on, I couldn't be happier with where we are today in terms of the breadth of our solutions, partnerships and market adoption.

We have over 250 publishers using our Identity Hub solution, which allows them to seamlessly manage multiple email-based or other identifiers and eliminates the need for publishers to build and maintain integrations on their own. We also offer key reporting insights, where publishers can test and learn the effectiveness of each ID solution.

9GAG, a popular social media platform in Hong Kong with a global audience of over 150 million users, used Identity Hub to quickly and efficiently adopt multiple alternative IDs via our solution. As a result, 9GAG drove increased programmatic revenue with Identity Hub, with alternative IDs helping them achieve a 10x lift in monetization on non-cookied traffic. This case study illustrates how our Identity Hub solution is moving the Open Internet forward for our customers, and at the same time is leading to increased utilization of our infrastructure, regardless of cookie deprecation timelines.

We continue to expand the impact of Identity Hub by adding identifiers. With up to 13 identity solutions now integrated, publishers can easily support multiple ID partners to ensure buyers can recognize the publisher's audience and bid accordingly.

We have also continued to scale our Audience Encore solution, where publishers and data partners can upload their first party audience data to our platform for ad buyers to access. We currently have 30 data partners, including Nielsen, Car Gurus, Semasio, and Hyp Technology APAC to name a few, and over 32,000 customer segments and inventory packages available for ad buyers to access. Importantly, we expanded our platform to include one of the largest data owners in the ecosystem, Google Audiences, in Q2.

For example, using our broad ecosystem of data partners combined with hundreds of billions of daily ad impressions, Dentsu was able to reach a niche audience like tech enthusiasts at scale with data enriched inventory. In the end, Audience Encore delivered on their volume needs with a viewability rate of over 70%, well above their 50% benchmark.

Last month, over 2,000 people registered to join our virtual conference, Envision, where over 120 leaders from around the globe discussed what's next for addressability. The consensus was clear – we need to look beyond solutions that replicate the cookie and instead focus on addressing the fundamental opportunity for a more transparent Internet, which will require a portfolio of solutions that protect consumer privacy and enable the safe, data-driven advertising of the future. We continue to invest in this area and believe we are well positioned to help our customers achieve their business goals in a post-cookie and post-IDFA advertising environment.

CONCLUDING REMARKS

I want to close by highlighting how proud I am of our entire team. We were recently awarded Best Supply-Side Platform by Adweek's Reader's Choice Best of Tech Partners. We have been recognized as a Top 100 Small and Medium workplace in Asia by the Great Place to Work institute. And we have partnered with Havas Media UK to power the supply in their Sustainability Marketplace, which is focused on furthering environmental, social, and economic causes.

These achievements underscore our focus on our culture and our customers. Our differentiated and profitable business model combined with our growing revenue visibility affords us the ability to invest deeply in a variety of growth opportunities. As a result, we are growing our market share across formats and devices and are well positioned to take advantage of the acceleration in digital ad spend in a fast-evolving market.

Let me now turn the call over to Steve.

CFO REMARKS

Thank you, Rajeev, and welcome everyone.

PubMatic achieved another outstanding quarter with revenue and Adjusted EBITDA above guidance, propelled by organic revenue growth more than double the rate of the overall digital ad market. Revenue in the second quarter was $49.7 million, an increase of 88% over Q2 last year. Net income was $9.9 million, more than 10 times higher than the prior year.

Adjusted EBITDA was $18.6 million, nearly 3 times higher. These exceptional top and bottom-line results reflect our success in delivering value to our customers and the strength of our business model with its high profit flow though to adjusted EBITDA and GAAP net income.

Underpinning our success is our long-term ability to innovate and invest for future growth. We are investing in solutions across devices and ad formats, adding new customers, increasing our infrastructure capacity, and expanding our engineering and go-to-market teams. We believe these investments combined with our proven ability to operate efficiently give us a powerful network effect with more revenue visibility and operational scale which benefits our customers and us. As a result, we are raising our full year 2021 guidance.

Given the strong momentum across our global business and progress with rapidly scaling growth initiatives including our supply path optimization relationships and our OTT/CTV business, we expect 2022 year over year revenue growth to be 25%, consistent with where we see our longer-term growth trajectory.

In conjunction with our higher revenue expectations, we will continue investing for growth. Inclusive of these investments, we remain confident that we can deliver annual adjusted EBITDA margins of 30+% for this year and next. I'll provide more color on this in a few minutes.

Our five key financial drivers give us confidence we can sustain revenue, adjusted EBITDA and GAAP net income growth.

1. First, we have one of the few scaled global businesses in our highly fragmented industry that offers an omnichannel solution for publishers and buyers. Our specialized cloud infrastructure and local go to market presence is geographically distributed in all the major ad markets apart from China. This framework allows us to continue expanding across the world with existing and new customers both effectively and efficiently.

2. Second, the combination of our usage-based model and our ability to retain and grow revenues from existing customers provides a high degree of revenue stickiness and corresponding visibility.

3. Third, we have built a business that consistently delivers high gross margins.

4. Fourth, our business model is embedded with durable structural advantages emanating from our owned and operated infrastructure and offshore R&D that enables us to cost effectively invest in technological innovation.

5. And lastly, we generate consistent cash flow, through rigorous working capital management and efficient capital expenditures.

Now turning to the highlights for Q2. Our revenue growth was driven by broad strength across our omnichannel platform and diverse set of advertising verticals. Except for political advertising, spending for every vertical was up significantly over Q2 2020, with the top 10 verticals in aggregate growing 100%.

Ad spending was particularly strong for our mobile and omnichannel video businesses with combined revenues growing over 100% year over year. As a reminder, omnichannel video is the sum of online digital video plus OTT/CTV. In aggregate, our mobile plus omnichannel video revenues represented approximately 65% of our total revenues in the second quarter.

Looking at just the OTT/CTV category, revenues from this business increased over 100% sequentially from Q1 2021 with 114 publishers monetizing inventory via these formats in the second quarter, up significantly from Q1. We launched our OTT/CTV solution mid-2020, and next quarter we'll be able to provide year over year growth rates.

In Q2, Apple released the latest IOS software eliminating IDFA. Thus far, the percentage of consumers who have decided not to be tracked for advertising is lower than anticipated and overall and the impact on our business has been minimal.

Further, our omnichannel platform positions us well to offset any impact as advertisers shift to alternative high ROI formats and channels.

In the second quarter, we also saw continued recovery in our desktop business with revenue growth of 72% over Q2 of last year.

Our Verizon Media Group revenues grew over 50% year over year and represented approximately 17% of our total revenues in the second quarter. This concentration level is down considerably from 2019 when VMG represented 28% of revenue. We continued to benefit in the quarter from strong existing customer revenues. For the twelve months ending Q2 2021, net dollar-based retention was 150%, significantly up over the comparable period a year ago.

It should be noted that this most recent trailing12-month period excludes the pandemic affected Q2 2020. The calendar year 2021 net dollar-based retention will naturally come down from this level as we lap our high 2nd half growth.

Another important long-term growth driver continues to be our Supply Path Optimization deals with advertisers and agencies. We have seen these relationships serve as a catalyst for buyers to consolidate ad dollars onto our platform with the percentage of spending coming via SPO deals more than doubling since the beginning of 2020.

To rapidly scale and take advantage of these growth opportunities, we have significantly increased platform capacity. With these investments, we processed over 20 trillion impressions in the second quarter, double what we processed for the same period last year.

Our long-term strategy of owning and optimizing our purpose-built infrastructure enables us to reduce our unit costs and sets us apart from other companies that rely on public cloud infrastructure. Illustrating this point, we successfully reduced our cost of revenue per million impressions processed by 27% year over year.

In Q2, we delivered a 74% gross margin, compared to 65% in the prior year. Exceeding our revenue targets in the quarter enabled us to achieve high marginal profitability. Once we have implemented our targeted capacity expansion at a point in time, we achieve leverage because our platform costs are largely fixed in the near term, typically a quarter out.

With respect to our Q2 operating expenses, the combination of increased headcount for growth, incremental public company costs and stock-based compensation, resulted in operating expenses of $26.4 million, up 61% year over year. Since the beginning of 2021, in pursuit of our growth goals, we successfully increased our global team by approximately 14% with key hires in technology and go to market.

The combination of rapid revenue growth, operational efficiencies, and ongoing benefits from investments in our business resulted in net income in the second quarter of $9.9 million, or 20% of revenue, up significantly from the 2% net margin a year ago. Q2 Diluted EPS was $0.18. Adjusted EBITDA in Q2 was $18.6 million, or 37% of revenue, compared to 19% of revenue in the prior year primarily due to the high flow through from strong revenue ahead of plan and the cost leverage we achieved on our platform.

To summarize, our strong quarterly P&L performance was the result of several factors:

- Acceleration of mobile and omnichannel video driven by the increase in Open Internet activity globally;
- Rapidly growing OTT/CTV business;
- Strong spending across nearly all ad verticals;
- Increased revenues from existing customers supported by Supply Path Optimization agreements signed in 2019, 2020 and 2021; and
- Our targeted investments in people and platform capacity.

Turning to our cash flow, we generated net cash from operating activities of $21.1 million for Q2. We ended the quarter with cash, cash equivalents and marketable securities of $122 million, up over $10M from the prior quarter.

Now, onto our Q3 and full year 2021 guidance. Given our strong first half performance, and increased visibility for the balance of the year, we are increasing our full year guidance for revenue and Adjusted EBITDA.

Before turning to the specifics, I want to provide some context. In light of uncertainty caused by emerging covid variants, we remain prudent and keep a slightly conservative stance in our full year guidance due to the combination of uneven macroeconomic conditions and the reality that some parts of the world are still suffering from the worst effects of the pandemic. Nevertheless, we are seeing the preliminary stages of an economic reopening in the US and in selected major ad markets around the world and we believe this trend will benefit PubMatic and its customers. Of course, it remains to be seen when the pandemic will end. At a minimum, we anticipate recovery and reopening trends will vary by region creating a degree of uncertainty. With this backdrop, it is worth noting that PubMatic's omnichannel platform and broad global presence gives us confidence that our business is resilient and well positioned for growth this year and beyond.

In terms of our investments for future growth, with our strong first half profit performance, the confidence we have in our efficient, omnichannel platform and our proven ability to operate profitably, for the remainder of 2021, we plan to accelerate hiring well ahead of our original 2021 plans.

Looking ahead to 2022, we intend to continue investing in people and infrastructure to maximize our growth potential in 2022 and beyond. On the capex side, we noted last quarter that we plan to continue adding capacity to capture incremental growth opportunities this year and we are accelerating purchases forward from 2022 to mitigate the risk of chip shortages over the coming 9 months. We also expect incremental costs related to office re-openings around the globe as well as higher travel and entertainment expenses as our team re-engages in person with customers.

Overall, we expect our GAAP operating expenses for Q3 and Q4 to increase at roughly similar year over year rates to Q2. In terms of the specifics, for Q3 2021, we expect revenue between $51 and $53 million, or 35 to 39% year over year growth.

In terms of the year over year percentage comparisons implied by our guidance, keep in mind we are lapping very strong growth in the second half of 2020 of 50% that also included one-time effects such as carryover spending from the first half and political ad spend. In this regard, it is useful to reference our growth on a two-year stack basis which translates for Q3 to 68% to 72% for the two-year period.

For Q3, we expect Adjusted EBITDA between $15 and $16 million, approximately a 30% margin.

For the full year 2021: we are raising our revenue expectations by $9 million and now expect revenue between $205 and $209 million, representing 38% to 40% year over year growth. On a two-year stack basis, our revenue guidance implies second half growth of 68% to 73%, similar to our first half.

We are also raising our full year Adjusted EBITDA expectations by $10 million and expect Adjusted EBITDA between $65 and $68 million or 30 to 32% margin.

For the remaining two quarters of 2021, we will be incurring new public company costs of over $4 million. We expect capex to be $26 to $29 million for the full year. A significant amount of our capacity investments will be put into service over the next several months and consequently, our Q3 and Q4 gross margins will be slightly below historical second half margin rates, due to depreciation costs brought forward from 2022. We don't see this affecting our calendar year gross margin target of approximately 70%.

In terms of our ad impression growth, we now expect the full year number of impressions processed in 2021 to increase by more than 70% compared to 2020.

In closing, we are pleased with our progress in the second quarter and first half of 2021, but we are even more excited about the opportunities ahead of us. At a fundamental level, we believe that the size of the digital advertising opportunity we can address is larger as the total amount of time people spend online continues to grow. Our differentiated business model built on an omnichannel platform positions us well to capture advertising opportunities across devices and formats wherever people go online. As a result of our strong financial position emanating from our efficient infrastructure, we are able to consistently invest in targeted growth initiatives like OTT/CTV.

We are seeing strong results across our global business and correspondingly expect our fiscal 2022 year over year revenue growth to be 25%, which corresponds to an organic three-year compound annual growth rate of 32%, well ahead of the expected growth in digital ad spend.

Given the strength of our business model, scaled global presence, increasing market share, and experienced team, we are confident we can deliver annual adjusted EBITDA margins of 30+% for this year and next, inclusive of our growth investments.

With that, I will turn the call over to Stacie for questions.