PubMatic

PUBMATIC Q2 2022 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, 2022. 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 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, 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 August 8th, 2022 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 welcome everyone.

We delivered another terrific quarter, with revenue growth and profitability exceeding our expectations. Our compelling combination of durable, profitable growth once again demonstrates our market leadership based on our differentiated, infrastructure-driven approach to digital advertising.

Organic revenue grew 27% year over year, well above market growth rates. In fact, we saw an acceleration in year over year growth as the quarter progressed, with June being our strongest month of the quarter. Our results demonstrate the number and magnitude of growth opportunities we have incorporated into our business. For Q2, key growth drivers that exceeded our expectations include broad strength in the Americas region, CTV publisher acquisition and existing publisher expansion, and Supply Path Optimization. We also benefited from a well-diversified portfolio of advertisers, with over 20 verticals contributing to growth. Our pace of growth reflects market share gains and our continued industry consolidation.

GAAP net income margin was 12% and Adjusted EBITDA margin was 37%. Our margin levels highlight the leverage in our model which, importantly, allows us to invest for the future, even during periods of macro-economic uncertainty or downturn. We believe this is a strategic advantage as we're able to invest in our platform, solutions and go to market efforts in a way that others may not be able to in uncertain times. Just as importantly, we generate healthy cash flows.

I'm incredibly proud of what our team has achieved in Q2. This quarter was our most challenging yet since our IPO given the number and magnitude of macro-events that are buffeting the economy, including inflation, rising interest rates, war in Europe, and ongoing supply chain disruptions. These challenges required us to be nimble and agile in order to serve our customers well and grow our business in a highly efficient manner. We rapidly developed software, leveraged our full operational control of our infrastructure, and continued to scale our go-to-market presence around the world.

BUILDING THE SUPPLY CHAIN OF THE FUTURE

I co-founded this company under the premise that programmatic advertising has the potential to fuel the endless potential of digital content creators. The news cycle of the past few months has reinforced this idea, with some of the world's most premium content companies announcing plans for programmatic advertising to be a critical component of their growth strategy. At PubMatic, we've built our business on the belief that all advertising will be digital, and all digital advertising will be transacted programmatically, and this is quickly becoming reality.

However, there are other crucial dynamics at play in our industry. With the rapid expansion of the digital advertising ecosystem, we are seeing both accelerated innovation and increased fragmentation across the supply chain, with new solutions emerging and M&A shaking up the market. At the same time, our industry is attracting more scrutiny from privacy and antitrust regulators around the world. As a result, our customers are increasingly looking for independent, unbiased solutions to help them navigate these changes and maximize the value of their advertising strategies. As champions of the open internet, we have developed the technology to enable both our customers, and us, to succeed.

We are building the supply chain of the future – one that is transparent, efficient, effective, privacy-compliant, data rich, and environmentally sustainable. Our focus on delivering the leading technology infrastructure to power this future is resonating with both new and existing customers, and is a key driver of our continued success.

This summer, I spent considerable time working outside of the US for the first time since the pandemic. I visited with customers, prospects and partners at Cannes Lions, the first in-person global gathering of media and advertising leaders from around the world since 2020, where there was an overwhelming interest from our existing customers to find new opportunities to grow our relationship and from prospects wanting to take advantage of our technology and infrastructure. I also spent time in London, Madrid and Milan, meeting with team members and customers from across the region. In fact, at one point I visited five countries in five days.

I met with publishers, advertisers, agencies, DSPs, and online retailers – a consistent theme across many of my meetings is that they are consolidating their business relationships to fewer, larger platforms. They no longer want to manage hundreds of vendors in their digital advertising supply chain – but are instead focused on deepening their use of key technology partners to create more efficiencies within their business while generating superior outcomes. I came away optimistic for deeper Supply Path Optimization partnerships with agencies and advertisers as our prior experience indicates that in times of economic stress, these entities lean into nimble, tech-driven partners that can increase their efficiency, help them save on operational costs, and enable new revenue streams.

PubMatic is a leader in this consolidation, as evidenced by our rapid growth, ongoing market share expansions, and strong Net Dollar Retention rate.

CONSOLIDATION FUELS GROWTH

Our deep and longstanding customer relationships and track record of solid performance create opportunities for expanded use of our platform. Increasing access to valuable inventory and our ability to generate high-margin revenue for publishers is fueling growth. For the trailing twelve months, net dollar retention was 130% - a stand-out achievement among our software peers.

On the buy-side of the ecosystem, consolidation is manifesting itself in several ways. In Q2, supply path optimization (SPO) represented approximately 30% of total activity on our platform, up from 24% a year ago. In addition, the efficiency of our platform and the access to inventory and audiences from top publishers is reinforcing the value of our platform to both publishers and buyers.

DSP partners are also engaging in consolidation, allocating more impression capacity to the PubMatic platform because of the quality of our inventory and the efficiency of our platform. For example, in Q2, a major DSP nearly doubled the impression capacity allocated to PubMatic versus Q1, which allowed us to grow their spend with PubMatic considerably. Importantly, this fuels our flywheel – as we attract more spend from buyers, publishers increase their revenue from PubMatic, which causes them to add more inventory formats, geographies, or properties to our platform, which in turn provides us with an increased ability to invest and innovate. We view this as a significant moat that we continue to scale as we secure growing capacity share from many of the largest DSPs.

CONSOLIDATION DRIVERS

With top publishers and buyers actively consolidating their spend onto PubMatic, our runway for growth has never been clearer. I remain as optimistic as ever that we will meet our long-term market share goals of 20% plus.

Customers and partners value our global, omnichannel scale as well as our robust solutions that solve for the future of audience addressability. They also benefit from the efficiencies gained from our owned & operated infrastructure, superior ROI outcomes, and our ability to invest in continued innovation on their behalf.

As macro uncertainties continue to unfold, it’s possible that the efficiencies gained from our platform accelerate consolidation. By partnering with us, less capital is needed for publishers or buyers to build out addressability solutions, proprietary header bidding wrappers, or inventory connections. In addition, buyers and publishers gain efficiencies from our already-scaled owned and operated infrastructure – which would take them years to achieve on their own. In an environment where investment and resources carry greater discipline, partnering versing building could be a strategic decision that accelerates industry consolidation onto those platforms that provide the most value.

OMNICHANNEL PLATFORM

Our omnichannel approach gives buyers flexibility as consumer trends shift. It also instills resilience as we are not dependent on a single format or channel for growth.

CTV, one of the fastest growing formats, has been getting a lot of attention in the market over the past couple of years, and rightly so. The rapid consumer behavior shift towards streaming has unlocked tremendous opportunity for the market, and we have certainly benefited from that momentum. In Q2, we saw an increase of over 150% year over year in our CTV business and we monetized inventory from 196 publishers as our pace of CTV new publisher acquisition accelerated.

At the same time, the bigger market opportunity will remain in programmatic online video ad spend, which represents 3- 4 times that of CTV/OTT. Our combined omnichannel video, including CTV, represented over 30% of revenue in Q2.

ADDRESSABILITY & SUPPLY PATH OPTIMIZATION

As we move towards a post-cookie world, third-party data is increasingly becoming less sustainable and relevant. Instead, the value of data is shifting to the sell side of the ecosystem, which is at the nexus of the publisher and the consumer. We see a significant role to play as a result of being a leading technology provider to top publishers around the world. For this reason, we have been investing in industry leading solutions in this area for over three years now.

We recently launched Connect, a comprehensive and fully integrated platform for media buyers to seamlessly connect with their target audiences across the open internet. Connect combines known identity, first- and second-party data, contextual signals, seller-defined audiences, and modeled audiences into one platform with robust reporting and transaction management capabilities.

Buyers are seeing the benefits of activating this data on the sell-side, closer to the consumer, in terms of both scale and performance. Sunscreen brand Banana Boat was able to achieve better campaign performance for a video ad campaign by activating Lotame's Panorama ID through our Connect platform, outperforming even cookie-based channels.

This case study not only demonstrates the value of PubMatic's Connect solution, but also how our technology prepares customers for the pending deprecation of the cookie. Lotame is one of multiple identity and data providers currently available to be targeted through Connect.

Our ability to connect audiences and media is driving further ad spend consolidation on our platform and will likely be a further driver of SPO. IPG's Matterkind and Omnicom Media Group's PHD Media have seen significant results for their clients through Connect. Additionally, major agency holding companies, such as Havas Media Group, are expanding their supply path optimization partnerships with PubMatic to take advantage of the cookie-less benefits of Connect, in addition to our omnichannel scale, efficiency, and nimble technology development.

EFFICIENT INFRASTRUCTURE

As more ad dollars flow into the open internet, buyers and publishers are seeking transparent and efficient advertising solutions. Our unique approach to digital advertising provides infrastructure in which all stakeholders benefit, which is all the more valuable in today's dynamic economic environment.

A further driver of our industry consolidation is the sustainable way in which we are building the digital advertising supply chain of the future, as our customers and partners are increasingly seeking responsible technology partners. Along with our commitment to delivering value to our customers, we remain committed to the sustainability of the environment in which we all live. This quarter, we announced that the energy used across our data centers is now 100% renewable energy. This is something we have been working towards for several years. With this announcement, any advertiser or agency looking to buy media in a sustainable way, and there is a rapidly growing group of buyers that are, can now do so on the PubMatic platform.

CONCLUDING REMARKS

As we look to the second half of the year, we will continue to see macro challenges. Q3 has typically been the most challenging quarter to forecast so we're being prudent in the very short term as advertisers adjust to the macro environment. As we take a broader, six-month view, we are confident in our ability to operate with the same agility we always have. History has proved our resilience through peaks and valleys, as our business is increasingly well diversified across verticals, ad formats and channels. Moreover, we have a significant number of growth opportunities that we are well positioned to take advantage of.

Despite the near-term economic uncertainty, we know our usage-based model drives market share gains as we consolidate the space. With consolidation comes greater visibility, diversity in the business and a widening competitive moat. It also fuels a high degree of profitability which allows us to focus on the long-term, creating value and innovation across the digital advertising ecosystem at every step.

Before I turn it over to Steve, I want to give a special thanks to our team for their strong execution in a challenging environment. Their commitment to our customers and partners is unwavering. The digital advertising landscape continues to evolve at a rapid pace, with growth to be had across formats, channels, geographies, and new addressable markets like retail media. I couldn't be more excited for the future and how we're positioned for continued consolidation and market leadership.

I also want to welcome Shelagh Glaser and Jacob Shulman to our board of directors and our Audit Committee. Shelagh brings decades of financial experience from her work at Intel and currently as CFO of ZenDesk. Like Shelagh, Jacob brings more than 25 years of experience building financial infrastructure and driving growth at multi-national enterprises. Jacob currently serves as CFO of JFrog. As we build for the future and continue to scale our business, their additions bring deep expertise to our organization.

Let me now turn it over to our Chief Financial Officer, Steve Pantelick, to provide additional detail.

CFO REMARKS

Thank you, Rajeev, and welcome everyone.

Our second quarter results exceeded our expectations and were noteworthy in light of the macro challenges across the globe. We delivered $63.0 million in revenue, representing year over year growth of 27%. GAAP Net income was $7.8 million, or 12% margin and fully diluted EPS was $0.14. Adjusted EBITDA was $23.0 million, or 37% margin. Our cash flow from operations was $20.5 million.

The second quarter marks our 8th straight quarter where we grew significantly above our long-term growth target of 20+%, our 13th straight quarter of positive GAAP Net Income, and our 25th consecutive quarter of positive Adjusted EBITDA.

These results, once again, underscore the durable nature of our revenue and profit growth built on the multiple growth drivers embedded in our business. They also vividly illustrate our diversified business within the open internet as well as our team's ability to consistently execute our business plan while navigating through obstacles and changing conditions.

REVENUE

Turning to the highlights in Q2, we saw the importance and value of being a scaled, omnichannel platform. Overall, advertiser usage increased in terms of the number of advertisers spending on our platform and average dollars spent.

Each of our top 10 ad verticals grew double digits year over year. In aggregate, ad spend for the top 10 verticals increased more than 40%. Shopping continued to be a strong performer while Travel extended its recovery and increased by over 100%. Food & Drink and Arts & Entertainment were also among the fastest growing categories. Automotive and Personal Finance, also included in our top 10 verticals, grew at a slower pace.

In terms of the progression of ad spending through the quarter, we saw softness early in Q2 for some verticals that was more than offset by strength elsewhere. This underscores the advantage of operating a platform with diverse business activity that appeals to a broad range of brand and performance advertisers across both physical goods and services.

In Q2 our year over year revenue growth accelerated led by mobile and omnichannel video which increased 43%. This growth was on top of the prior year’s growth of more than 100%. Overall, mobile plus omnichannel video represented a record high 72% of our total revenues. The star of the quarter was omnichannel video, which grew 58%. Within omnichannel video, CTV revenues increased more than 150% year-over-year. Underscoring the diverse activity on our platform, our total display business also accelerated compared to Q1 and increased 19% year over year.

In terms of our regional growth, there was some softness in EMEA and APAC, but all regions grew double digits. Americas delivered above expectations.

Supply Path Optimization relationships continue to play a key role in terms of our growth and revenue stickiness as advertisers and agencies expand usage of our platform. In Q2 we signed new SPO deals, renewed existing agreements and expanded activity via these deals. We plan to continue investing behind this opportunity focused on helping buyers find the right audiences and media on our platform. The proportion of SPO activation to total ad spend increased from Q1 and represented approximately 30% of activity on our platform.

An important indicator of publisher satisfaction and usage of our platform is net dollar-based retention. On a trailing twelve-month basis, net dollar-based retention was 130%. As communicated in prior quarters, this metric has normalized now that Q2 2020 results are no longer in the comparison set.

GROSS MARGIN

Our continued success in achieving high gross margins is the result of our strategy and execution. We aim to put into service our planned maximum capacity every calendar year by the beginning of Q4. Once capacity is put in place it becomes a fixed cost in the near term that we then leverage over the succeeding periods. In seasonally lower spend periods such as Q1 and Q2, our gross margins are typically lower than second half levels.

As the year progresses, the combination of ongoing infrastructure optimization, the expansion of activity with our new and existing customers and higher seasonal ad spending results in significant gross margin leverage.

By owning and operating our infrastructure we have been able to drive down our unit costs. Over the last two years, we have reduced our cost of revenue per million impressions processed by approximately 50%. Our experience has shown us that the return on investment for incremental capacity is high and typically pays for itself on a cash basis in months. With this cost advantage, where we see incremental revenue opportunities, we will expand our processing capacity and further increase our competitive moat.

OPERATING EXPENSES

In Q2 we continued making investments in innovation and adding go-to-market team members. These investments coupled with our focus on operational excellence, have been instrumental to our strong financial results. Operating expenses in the second quarter were $34.3 million, up 30% year over year, reflecting a combination of increased headcount for growth and stock-based compensation. Excluding stock-based compensation, Q2 operating expenses increased 27%.

NET INCOME AND ADJUSTED EBITDA

Q2 GAAP net income was $7.8 million. Non-GAAP net income, which adjusts for stock-based compensation, the unrealized gain or loss on equity investments, and related income tax effects, was $13.0 million or 21% of revenue.

Diluted EPS was $0.14 and Non-GAAP diluted EPS for Q2 was $0.23.

BALANCE SHEET AND CASH

Turning to our cash flow, we generated net cash from operating activities of $20.5 million in Q2. Our free cash flow was $5.7 million. We ended the quarter with cash, cash equivalents and marketable securities of $183.0 million and no debt.

FINANCIAL OUTLOOK

Now, looking to the second half of the year, we have been closely monitoring recent trends. Based on our assessment of the uncertain economic environment and factoring in both headwinds and tailwinds, we are taking a conservative approach to our guidance.

In terms of headwinds, we are anticipating further softening of European consumer demand amid worsening economic conditions stemming from uncertainty around energy supplies to high inflation and rising interest rates. In the APAC region, as a result of periodic Covid-induced lockdowns that affect both the supply chain and consumer activity, we expect muted ad spending through the end of the year. In the Americas, we anticipate some limited softness but are assuming generally stable economic conditions for the balance of the year.

In terms of tailwinds, we continue to see strong momentum with our SPO relationships, continued growth of our online video and CTV businesses and incremental political ad spend that will offset some of these challenges. We also anticipate continued benefits from PubMatic's diversified business within the open internet ecosystem.

Taking these headwinds and tailwinds into consideration, beginning in Q2, we proactively initiated several cost saving measures. We re-prioritized our hiring for the balance of the year and moved some incremental hiring to 2023 as well as reduced a portion of discretionary expenses such as marketing and T&E. Including savings achieved in Q2, we anticipate unlocking several million dollars of savings by the end of the year relative to our original planned expenses.

We proactively took these steps because a hallmark of our long-term success has been agile execution in a changing environment, coupled with our dual focus on revenue growth and profitability, which ensures we have the resources to consistently invest for future revenue opportunities.

For Q3, specifically, we expect revenue of between $66 and $68 million or 15% at the midpoint for year over year growth. Keep in mind that we're comparing against a 54% growth rate from Q3 last year. On a two-year stacked basis, our guidance translates to approximately 70% growth.

We expect Adjusted EBITDA between $23 and $25 million, or approximately a 36% margin at the midpoint.

For Q4, we are adopting a conservative outlook as well based on the challenging economic factors cited earlier. To be clear, we remain optimistic about growth from our SPO relationships, continued ramp up of our omnichannel video business and incremental political ad spending.

Based on our revenue over achievement in Q2 and the de-risking of our second half, we are revising our full year revenue guidance to $277 to $281 million or 23% growth at the midpoint. With digital advertising slated to grow approximately 12% in 2022, we are well positioned to continue to grow our market share.

With the operating expense savings already in process, we anticipate that total second half GAAP operating expenses will be lower than previously communicated. We now expect full year operating expenses to increase approximately 30%. Due to the timing of investments, Q3 operating expenses will increase at a slightly faster rate year over year and Q4 expenses will increase at a slower rate.

As a result of our increasing global scale and favorable revenue mix towards high margin video formats combined with the cost optimization plans in place, we are increasing our full year Adjusted EBITDA range to between $103 and $108 million, or 38% margin at the midpoint.

As has been the case in previous challenging environments we have successfully managed through, we will continue making targeted, high ROI investments in pursuit of long-term market share gains. Our investment plans come from the conviction that we are still in the early days of our growth and we see clear benefits from consistently investing to capture these large opportunities ahead of us. As previously shared, approximately 40% of our capex this year is focused on driving the newest and fastest growing segments of our business including new SPO capabilities, CTV expansion, and private marketplace scaling and efficacy. This latter category, for example, grew over 150% this past quarter, and is becoming an increasingly important part of our business.

We anticipate capex between $33 and $36 million this year. Based on timing of equipment availability and shipments, the bulk of our capex will occur this quarter and will reduce our free cash flow. We anticipate a return to a more typical pattern of free cash flow generation in Q4. Looking ahead, as video and other high value formats become a greater share of our revenue mix, and as we continue optimizing new infrastructure, we anticipate that our capex to revenue ratio will decline.

With regard to the strengthening of the US dollar, we anticipate the impact on our revenues to be neutral to positive because the transactions flowing through our platform are largely denominated in US dollars. On the expense side, we also expect the US dollar's strength relative to the Indian rupee and UK British pound sterling to have a neutral to positive impact.

IN CLOSING

In closing, our second quarter results underscore the strength of our platform, and our team's ability to consistently execute our business plan while navigating through challenging conditions. These factors give us confidence in our long-term prospects.

We believe we have the right platform and the right approach to be at the forefront of our industry. We have built a business with structural advantages emanating from our owned and operated infrastructure and offshore R&D that enables us to expand our competitive moat and consistently invest in innovation on behalf of our publishers and buyers.

We see a long runway of growth ahead of us as our TAM continues to grow and we are well positioned with multiple growth drivers. We are consolidating the sell side as one of the few scaled, global omnichannel platforms. And our profitability gives us a high degree of agility and the ability to consistently invest for long-term market share gains.

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