PubMatic

PUBMATIC Q2 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 August 8th, 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, Non-GAAP Net Income and Free Cash Flow. 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.

We drove strong results with outperformance on the top line, driven by the strength of our omnichannel platform and deep relationships with customers and partners. Adjusted EBITDA was $12.0 million, which includes the impact from a Demand Side Platform customer that filed for bankruptcy. Excluding this impact, adjusted EBITDA would have been $17.7 million, highlighting the strength of our business model and our ability to drive incremental profit and generate healthy free cash flow.

©2023 PubMatic, Inc. PubMatic is a registered trademark of PubMatic, Inc., U.S. Pat. & Tm. Off. and other countries. Other trademarks are the properties of their respective owners.

As we highlighted at the beginning of the year, we continue to focus on deepening our customer relationships and making highly focused innovation investments that we believe will position us for outsized share gains when digital ad spend growth inevitably turns upward. This strategy continues to yield results and is strengthening our position within the ecosystem. We continue to build deeper, stickier relationships with customers. At the same time, we are adding new publishers and buyers to our platform. Our total number of active customers grew 13% year over year, and we are now monetizing inventory from over 1,750 publishers. In the last year, we've also increased the number of advertisers on the platform by almost 30%. New product innovation is driven by this same land and expand approach. The two major technology launches we have announced this year – Activate and very recently Convert – each significantly expand our total addressable market while providing incremental growth opportunities with our existing customers.

We do all of this on our owned and operated infrastructure, which allows us to deliver productivity and efficiency gains that we anticipate will improve margins in the future. These efficiencies also benefit our customers, which in turn drive greater customer success and expansion on the platform.

In the near term, the current digital advertising market continues to be fluid. Many advertisers remain cautious about the economic environment as they closely manage ad budgets in case of a potential recession, particularly around brand advertising. In addition, current supply growth is outpacing ad budget growth. Combined, these two factors are resulting in an industry-wide downward impact on CPMs or ad pricing in the short term. This will normalize once ad budgets stabilize and start to grow. As a result, impression volume on the PubMatic platform continued to grow in the second quarter, however CPMs were softer than expected, particularly in June with continued downward trends in July.

Despite these headwinds, we remain in a leadership position. We have increased capacity on our platform toward higher value formats, optimizing for impressions that command higher overall CPMs. I am confident in our growing list of long-term revenue drivers and ability to gain market share. We have a strong and sustainable financial profile, and our deep technology innovation is widening our competitive moat. What's more, we benefit from industry-wide shifts and consolidation.

MACRO ENVIRONMENT ACCELERATES SHIFT IN INDUSTRY TRENDS

The current macro environment is forcing publishers and buyers to do more with less. Publishers are looking to better monetize their inventory across a wider set of channels and formats, and they are abandoning homegrown technology and increasingly relying on technology providers such as ourselves. At the same time, buyers are seeking greater efficiencies and control across their digital advertising supply chains. Both require integrating leading global, omnichannel, and transparent technology solutions that are market leaders in innovation.

This trend is rapidly playing out across the broadcast industry, resulting in a shift from traditional, guaranteed upfront media buying to a scatter market, or programmatic approach. Publishers – including large CTV publishers - are following suit in order to maintain access to advertiser budgets. As we predicted at the time of our 2020 IPO, we are seeing the programmatic disruption of CTV take hold.

As a result, we delivered over 30% growth in CTV, and our pipeline of tier one streamers is growing. We are in active conversations with dozens of CTV publishers, including some of the biggest names in streaming media. We have new and expanded partnerships with premium video providers including AMC Networks, DIRECTV, Fox Digital, TiVO and Warner Brothers Discovery EMEA. Accelerating this pipeline is Activate, which provides publishers with unique buyer demand not available elsewhere.

As buyers continue to consolidate via Supply Path Optimization, we've increased our sales focus and investments in this area. As a result, activity from SPO continues to climb. In the second quarter, SPO made up over 40% of activity on our platform, an all-time high. Our long-term expectation has been that SPO would eventually reach 50% or more of total activity, and we are well on our way to reaching this milestone. Not only is SPO a significant contributor to top line growth, but it's an important driver of incremental, long-term margin expansion.

©2023 PubMatic, Inc. PubMatic is a registered trademark of PubMatic, Inc., U.S. Pat. & Tm. Off. and other countries. Other trademarks are the properties of their respective owners.

FOCUSED INNOVATION FOR LONG-TERM GROWTH

Our continuous reinvestment of profit into targeted innovation underpins our long-term growth strategy.

With generative AI, we can further expand and accelerate our innovation. While still early, we are seeing gains in engineering productivity across many use cases, including building proofs of concept for future products. We're also seeing greater efficiencies through use of generative AI to increase automation, such as software testing. As a result, we have already started to shift hiring away from software testing engineers to feature development engineers. It's still very early in the application of generative AI and we continue to experiment with many different opportunities.

ACTIVATE

Exactly three months ago, we launched Activate, our end-to-end SPO solution that enables buyers to execute non-bidded direct deals on PubMatic's platform while accessing CTV and premium video inventory at scale. Activate represents a nearly $65B expansion of our total addressable market.

We couldn't be more pleased with the industry reception and interest that this highly innovative product has received. We're seeing traction and enthusiasm across every region and having active agency and advertiser discussions with several dozen accounts.

We are hard at work building more features into the platform based on our vision and customer input. While we are scaling up existing customers and adding new ones, we are investing in building out a global customer success team to help our customers expand their usage of Activate. Over the next couple of months, we will extend the availability of Activate from the Americas and EMEA regions into APAC.

CONVERT FOR COMMERCE MEDIA

Two weeks ago, we launched Convert, our unified solution for commerce media that leverages our global infrastructure, ad monetization expertise, and customer relationships.

Over the years, we've built relationships with retail and commerce customers, and have gained a deep understanding of the unique technological challenges they must solve for in order to build out their multi-pronged ad businesses. One of the biggest challenges that these retailers or commerce media participants face is the fragmentation of the advertising ecosystem, and the complexity that it creates.

For example, a grocery store chain may use one platform for their onsite sponsored product listings, another for onsite display and video ads, and yet another for offsite audience extension across the open internet. Not only does this require their teams to learn multiple systems, but their advertising data is also proliferated across various partners, causing challenges for closed loop reporting and optimization, in addition to privacy or data security concerns. For advertisers, this challenge is multiplied across the different retailers they want to work with.

Our latest offering, Convert, is built to solve these challenges by centralizing commerce media capabilities in a single, self-service platform that offers onsite and offsite monetization across a variety of ad formats, including our newly available sponsored listings capability.

For the past two years, we have been building the new platform to work for both traditional retailers as well as high-transaction businesses such as transportation or food delivery providers, travel companies or any scaled commerce company that processes transactions. We have seen strong interest among commerce companies around the globe, including rideshare provider Lyft, and Wallapop, a leading European classified listings site.

By integrating sponsored listings into our existing omnichannel solutions – CTV, video and display - all onto a single platform, agencies and advertisers can easily access all available inventory and programmatically deploy working media

©2023 PubMatic, Inc. PubMatic is a registered trademark of PubMatic, Inc., U.S. Pat. & Tm. Off. and other countries. Other trademarks are the properties of their respective owners.

dollars with the same transparency in fee and pricing structures that PubMatic is known for. Major media buyers like dentsu, IPG, and MiQ are partnering with us to help their advertisers more efficiently scale access to commerce media inventory and data.

With the addition of Convert to our growing software suite, including our SSP and Connect, we now offer a comprehensive solution for commerce media that allows commerce media networks to tap into PubMatic's nearly two decades of success helping media and data owners safely and securely monetize their assets programmatically. With this launch, we are significantly expanding our total addressable market by $10 billion and growing. Much of this TAM expansion is from performance marketing budgets, which will allow us to further diversify our business beyond brand ad spend.

CONCLUSION

I'm extremely proud of our team and all that we've accomplished so far this year. We've increased impression capacity to accelerate the shift in our business toward higher value formats and channels, while also significantly expanding our TAM with the launch of two innovative solutions. Our land and expand strategy is proving successful, adding more publishers to the platform and building stickier relationships with existing customers and partners. We remain a leader in a rapidly evolving industry and our investments and achievements today strategically position PubMatic for long-term, durable growth. We believe the industry will continue to consolidate, strengthening the leaders in the space that provide omnichannel, global scale and creating more opportunities along the way for technology innovation to play an even bigger role across the ecosystem.

I'll now hand it over to Steve for the financial details.

CFO REMARKS

Thank you Rajeev and welcome everyone.

Q2 revenue was $63.3 million, above guidance, and adjusted EBITDA was $12.0 million, which includes an unexpected bad debt expense related to the bankruptcy of a top 10 buyer. Excluding this one-time expense, adjusted EBITDA would have been $17.7 million or 28% margin.

In Q2, we prioritized the initiatives that strengthen the foundation of our business and position us well for long-term growth. We focused on operational excellence, customer relationships and innovation.

We delivered incremental efficiencies from our owned and operated infrastructure and generated $10.8 million in free cash flow.

We increased activity from SPO deals to over 40%, an all-time high.

And, importantly, we launched high value product innovation, with the recent launch of Convert, a unified self-service platform for commerce media and our buyer focused Activate offering last quarter. These two new areas are expected to increase our long-term TAM by over $75 billion.

REVENUE

Turning to the key revenue drivers in Q2, monetized impressions increased year-over-year while CPMs were lower. Reflective of the cross currents we are seeing in the macro environment by region and ad vertical, trends varied by format and channel.

©2023 PubMatic, Inc. PubMatic is a registered trademark of PubMatic, Inc., U.S. Pat. & Tm. Off. and other countries. Other trademarks are the properties of their respective owners.

CTV continued to be a high-growth channel for us, driven by an increase in monetized impressions, partially offset by lower CPMs. Overall, CTV revenues increased over 30% year-over-year. Online video monetized impressions, across mobile and desktop, also increased, but experienced double digit percentage CPM declines that pushed revenues down more than 10% year-over-year. Total omnichannel video revenues, which span across mobile, desktop, and CTV devices, declined 4% year-over-year and represented approximately 31% of total revenues.

Display monetized impressions, across mobile and desktop, grew year-over-year while CPMs declined. Overall, display revenues were down minus 1% year-over-year as compared to minus 8% in Q1. Display revenues represented 69% of total revenues.

In terms of ad verticals, while the top 10 grew 8% year-over-year, we saw a divergence of trends across categories. Four of the top ten verticals increased double digit percentages year-over-year led by the Food & Drink vertical at over 30% growth. Five of the top ten grew in the low to mid-single digit percentages, while Shopping was the only top ten vertical that declined year-over-year in the high single digits.

On a regional basis, EMEA grew over 16% year-over-year, while the Americas declined by 1%.

In terms of the monthly progression through the quarter, April revenues were flat and May revenues increased year-over-year. June revenues declined driven by softness in both online video and display CPMs.

OPERATIONAL STRENGTH

Turning to our operational strength, our Q2 financial results benefited from increased efficiencies and optimization of our owned and operated infrastructure.

Overall impression processing capacity increased over 30% year-over-year, largely driven by software optimizations with minimal incremental capex.

On a trailing twelve-month basis our cost of revenue per million impressions processed declined by 12%.

The combined impact of our operational efficiency and business model leverage enabled us to achieve outstanding marginal profitability. Approximately 85% of every incremental revenue dollar above Q1's level, converted to gross profit in Q2. This capability is a key differentiator for us and has enabled us to achieve consistent profitability for a decade while building the foundation for future growth.

OPERATING EXPENSES

In terms of operating expenses, Q2 GAAP opex was $45.4 million. Included in this total were incremental costs of $2.1 million related to our acquisition of Martin in September last year and $5.7 million in bad debt expense related to the bankruptcy of one of our buyers. Excluding these incremental costs, operating expenses increased less than 10% year-over-year.

NET INCOME

In Q2, GAAP net loss was $(5.7) million, or minus $(0.11) per diluted share. Excluding the impact of the bad debt expense, we would have delivered GAAP net loss of $(49,000).

Q2 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 $1.3 million, or $0.02 per diluted share. Excluding the $5.7 million of bad debt expense, non-GAAP net income would have been $7.0 million.

©2023 PubMatic, Inc. PubMatic is a registered trademark of PubMatic, Inc., U.S. Pat. & Tm. Off. and other countries. Other trademarks are the properties of their respective owners.

BALANCE SHEET AND CASH

Turning to cash, we are in excellent financial shape and ended the quarter with $170.9 million in cash and marketable securities and no debt. We generated $15.8 million in cash from operations and $10.8 million in free cash flow.

Our consistent cash generation is an important driver for our long-term growth and market share gains as it allows us to consistently invest in innovation.

As of July 31, we have repurchased 1.8 million shares of our Class A common stock for $27.5 million in cash. We have $47.5 million remaining in the repurchase program.

FINANCIAL OUTLOOK

Now turning to our outlook.

In light of recent trends, we remain cautious about the next couple of quarters. On the one hand, many advertisers, particularly brand-centric, remain cautious about the economic environment and are tightly managing ad budgets in case of a potential recession. On the other hand, current ad supply growth is outpacing ad budget growth. In June and July, we saw the impact of these factors with both softening of ad spending by vertical and pressure on CPMs.

To illustrate this point, for the combined April and May periods, ad spending for our top ten ad verticals grew 9% vs. the same period last year. For the June / July period, the top ten ad verticals slowed to 1% year-over-year. A notable change in trajectory was observed in four consumer centric verticals: Shopping, Technology, Personal Finance and Arts & Entertainment. In aggregate, they were down 7% for the June/July period vs. the same period last year.

Video CPMs took a 10% step down in July vs. June. Display CPMs showed a similar pattern of softening in July. Our outlook for August and September assumes that CPMs remain relatively flat to what we saw in July. Given the progression of CPMs over the last 12 months, on a year-over-year basis, this translates to roughly 20% lower CPMs for video and 10% lower CPMs for display in Q3.

On the positive side, monetized impressions continued to grow in July sequentially vs. June and vs. last year. July online video impressions increased over 20% year-over-year. CTV impressions increased in the single digit percentage range as they were lapping approximately 300% volume growth in the prior July. And display impressions increased 5% over last year. We anticipate these volume trends will continue through Q3.

As a reminder, we are proactively taking steps to diversify our revenue mix by adding more higher-growth formats and channels. For the first half of 2023, we increased the number of high-value omnichannel video impressions monetized by 15% over the first half of 2022, while monetized display impressions increased 2% over the same time period.

While these efforts will provide long-term, durable growth and margin expansion, they will not outweigh the soft CPMs that we project for Q3.

We anticipate that Q3 revenue will be in the range of $58 to $61 million. The format and channel projections underpinning this guidance are:

- display revenues will decline in the single digital percentage range;
- online video revenues will decline by approximately 10% year-over-year, similar to what we saw in Q2; and
- CTV revenue, which grew over 150% last year, will decline on a year-over-year basis.

Also influencing our near-term outlook is the recent bankruptcy of one of our top 10 DSP buyers on June 30th. We estimate that it will take several months for this ad spend to be fully redistributed to other buyers already integrated on our

©2023 PubMatic, Inc. PubMatic is a registered trademark of PubMatic, Inc., U.S. Pat. & Tm. Off. and other countries. Other trademarks are the properties of their respective owners.

platform. This transition will reduce our second half revenue by several million dollars. In the long run, we do not expect this development to have a material effect on our business.

Assuming macro conditions do not worsen, we estimate that Q4 revenue will grow sequentially from Q3, consistent with the lower end of typical seasonal trends. In terms of potential upsides, if CPMs declined at roughly half the rate we are currently assuming, we estimate it would add $3 million of incremental revenue per quarter.

On the cost side, we have been taking actions to drive incremental productivity across every aspect of our business and you can see the positive results in our Q2 financials. For example, we successfully added approximately 20% incremental processing capacity by the end of Q2, without a corresponding step-up in capex. This accomplishment means that we expect our second half GAAP cost of revenue on an absolute dollar basis will exhibit very limited quarter-to-quarter sequential cost increases despite impressions continuing to grow. As a byproduct of our leveraged business model, in the near term, we expect any uptick in CPMs beyond our current expectations to result in strong marginal profitability. We anticipate that over the long run these efficiencies will have a compounding effect and will drive higher gross margins for us.

As previously noted, our Q2 GAAP opex includes a one-time incremental bad debt expense of $5.7 million. Adjusting out this cost, we anticipate that Q3 opex will be roughly flat compared to Q2. We anticipate that Q4 opex will increase sequentially from Q3 in the low single digit percentage range as we add incremental innovation investments supporting our Activate and Convert products.

Given our revenue guidance and our optimized cost structure, we expect Q3 adjusted EBITDA will be between $13 and $15 million or approximately 23% margin at the midpoint.

Turning to capex, our capacity optimizations and operational efforts to drive higher value impressions onto our platform have been going well. We expect a further reduction in full year capex and now project capex at $10 to $13 million. This would be a reduction of more than 70% compared to our 2022 capex of $36 million. We expect these initiatives and others in the pipeline will enable us to incrementally increase free cash flow over time.

IN CLOSING

To summarize, over many years, we have built a resilient and durable business that is one of the world's leading, scaled, global SSPs. In Q2, we continued making progress on the three operating priorities that I outlined last quarter.

1. Generate significant free cash flow. Through the first half of 2023, we have delivered more than 40% of last year's level. It should be noted that with the recent DSP bankruptcy, we expect Q3 free cash flow will be below normal trends but we anticipate a return to robust free cash flow in Q4;

2. Position ourselves for revenue acceleration when ad spend and CPMs stabilize. Despite near term pressure in CPMs, we remain confident in our long-term growth opportunity, as evidenced by our ability to continue increasing monetized impressions. We are building deeper relationships with publishers and ad buyers, expanding our TAM by bringing innovative new products like Activate and Convert to market, and scaling higher value formats like CTV and online video. We anticipate that our new product offerings will add to our revenue growth in the second half of 2024; and

3. Establish a new level of efficiency in our cost structure that will lead to margin expansion in 2024 and beyond.

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

©2023 PubMatic, Inc. PubMatic is a registered trademark of PubMatic, Inc., U.S. Pat. & Tm. Off. and other countries. Other trademarks are the properties of their respective owners.