PUBMATIC Q3 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 third quarter ended September 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 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 September 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 November 9, 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, Stacie, and welcome everyone.

For the fourth consecutive quarter, we delivered exceptional results, well ahead of our expectations. As an industry leading sell-side platform, we significantly outpaced market growth, invested for future growth, and continued to fuel our profitable business model. We generated:

- Record revenue of $58.1 million, or 54% organic growth over last year;
- $13.5 million in GAAP net income, or 23% margin, an increase of 117% over last year;
- $24.3 million in Adjusted EBITDA, or 42% margin, inclusive of growth investments; and
- We generated a record $26.4 million in cash from operations in the quarter

KEY DYNAMICS OF OUR MARKET OPPORTUNITY

There are two key market dynamics underway that are fueling our strong results. First, just as the demand side of the ecosystem consolidated over the last five years, the sell side is actively consolidating at a rapid rate with clear winners emerging based on innovation and value delivery to customers. And second, the market continues to grow at a rapid pace, with elevated digital ad spend expected for the foreseeable future.

On the back of these trends, I'm pleased to share that our latest results mark four consecutive quarters where we have exceeded both 50% year over year revenue growth and 30% adjusted EBITDA margins.

OUR DIFFERENTIATED APPROACH

Before I go further, I would like to address the recent industry concerns about the impact of Apple's removal of the IDFA. This is not an industry-wide issue. iOS based advertising is a small part of our business, mid-single digits on a percent of revenue basis, so its impact at most is very limited for us. We are a well-diversified omnichannel platform with scale in mobile web, desktop, and CTV, which includes OTT, as well as iOS and non-iOS app environments.

Equally important, we have anticipated Apple's and other similar changes for several years and have been hard at work innovating to get ahead of them. For example, our Identity Hub and Audience Encore solutions, which bring valuable identity and first-party data to our platform, continue to scale aggressively. Over two-thirds of our revenue has alternative identifiers to the third-party cookie and Apple's IDFA in place, up from a majority of revenue at the end of Q1.

At a macro level, we are a brand advertising platform first, and a direct response platform second, so conversion-based attribution and associated measurement challenges are relatively less impactful for us. And finally, we have a well-diversified set of advertiser verticals on our platform. Steve will have more detail on that later in this call.

Now, moving on, as of the time of our IPO, we estimated that we had 2-3% share of the addressable market, programmatic non-walled garden advertising, with ambitions to grow our market share by 10X in the years ahead.

We do this through a land and expand approach, coupled with a usage-based revenue model, similar to other leading high-growth software companies. In contrast to traditional SaaS business models, when we deliver incremental value to our customers, we participate in their upside. As a result, we are growing at 2-3X the growth rate of the market.

Our strong customer alignment also drives high revenue retention rates and provides a greater level of visibility into our future revenue, giving us the confidence to raise full year 2021 expectations for the third time this year. We now expect over 50% year over year revenue growth.

THE PUBMATIC FLYWHEEL

Our usage-based model incentivizes us to continuously innovate on behalf of both publishers and buyers with the objective that they expand their activity on our platform. Buyers expand usage by concentrating a higher share of their growing digital ad budgets on our platform. Publishers expand usage by monetizing more of their ad inventory on our platform at higher CPMs. All of this is done via seamless self-service interfaces or APIs for publishers and buyers, which makes it easy for them to do business with us.

We have spent many years building the foundational elements that support the flywheel to our usage-based model - our technology platform, our team, and breadth of customers. The more value our platform delivers, the more our customers expand their usage, and the more high-margin revenue we generate, enabling us to continuously re-invest in the core growth drivers across our business. Importantly, we have been profitable for many years, providing the investment dollars for us to accelerate the flywheel even further. Let me first talk about how we create value for ad buyers.

EXPANDING USAGE WITH BUYERS

Buyers are rapidly consolidating ad spend on PubMatic, driven by Supply Path Optimization, or SPO, a trend we pioneered several years ago.

Buyers spend more with us, and expand their usage of our platform, because our differentiated solutions increase their ROI. We offer workflow automation, data integrations, audience addressability solutions, and high-quality inventory, all via our global, omnichannel and transparent infrastructure.

The addressable market for Supply Path Optimization is increasing. In the third quarter alone, we entered into a record number of advertiser SPO deals. Additionally, as third-party cookies and Apple's IDFA are phased out, the value proposition we deliver to buyers drives further expansion, particularly via SPO.

A significant industry transition is underway, in which the value of data is shifting from the buy side of the ecosystem to the sell side, or publishers. Our unique access to first-party data via publishers combined with our rapid innovation and long-term focus on this opportunity is driving great results. For example, Omnicom Germany and Netherlands used data from our Audience Encore partner, Semasio, and applied it directly on the PubMatic platform rather than via their Demand Side Platform. As a result, Omnicom more than tripled the reach of their campaign when compared to applying the same data in their DSP. Further, Omnicom saw significant uplift in viewability and click-through-rates as we optimized inventory supply for their needs. Results like these create sticky buyer relationships, increase ad spend on PubMatic, and demonstrate how SPO creates value via increased advertiser ROI.

Over the next 3-5 years, we believe every major agency and advertiser, and many of the smaller ones, will engage in Supply Path Optimization. We are one of only a couple of Sell Side Platforms that meets buyers' criteria for being global, omnichannel, and independent of any owned media.

EXPANDING USAGE WITH PUBLISHERS

Our strategy with publishers is to continuously innovate and deliver more products that allow our publishers to increase the monetization of their ad inventory – whether through higher CPMs or through monetization of incremental ad impressions. We do this through a land and expand strategy which increases our platform utilization. This in turn drives unit costs down and creates a larger pool of profitable impressions for us to monetize. This approach drives our profit growth and accelerates our flywheel.

A publisher's journey with PubMatic typically starts with their need to generate revenue by monetizing their digital ad inventory. As publishers generate strong revenue through PubMatic, they are incentivized to add more inventory to our platform, including additional digital properties and additional ad formats. Newer formats, like CTV, fuel significant growth for us and provide a path for new publisher acquisition or expansion of addressable inventory within our existing publisher base.

In the third quarter, CTV revenue grew over 7X year over year and our publisher count jumped to 154. CBS Local and Meredith are examples of landing in desktop and mobile app and expanding with CTV inventory. Other publishers, like Crackle and Newsy, started their deployment with us in CTV, and expanded into additional formats and products over time.

Publishers also expand their usage of our platform through new product adoption. These products, such as Identity Hub for identity data, Audience Encore for first-party data activation, and OpenWrap for header bidding management create very sticky publisher relationships and add continued value throughout the publisher journey. Ultimately, these factors lead to our industry-leading net dollar-based retention of 157% over the last twelve months. We believe our broad product portfolio is a strong competitive moat for our business that also improves our forward revenue visibility.

CONCLUDING REMARKS

Our track record indicates we are driving a distinct combination of high revenue growth and GAAP profitability. Our infrastructure driven approach to digital advertising is highly differentiated, resulting in profitability that allows us to continuously re-invest in innovation, which in turn drives increased customer usage of our platform. Our usage-based business model, which is similar to some of the fastest growing software companies in the world, allows us to share in the value we create for customers and further accelerates our flywheel.

The omnichannel, global, and independent nature of our platform positions us to capitalize on a large and growing addressable market, with significant runway ahead of us to grow our market share. We continue to invest aggressively in a variety of growth initiatives, such as Supply Path Optimization, audience addressability, and high-growth formats like CTV, mobile, and online video, as well as our owned and operated infrastructure, in order to enhance our moat and grow customer usage.

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 Q3 results were outstanding on a number of fronts. We saw significant top and bottom-line organic growth, we generated material cash flow from operations, and we delivered our third consecutive quarter well ahead of guidance. Our strong performance is driven by our well-diversified omnichannel platform, global scale and a robust usage-based model. These factors collectively have made our business both resilient and durable, giving us the confidence to significantly raise our full year guidance.

Revenue for the third quarter was a record $58.1 million, an increase of 54%. This rapid growth was a significant acceleration on top of last year's 33% year over year growth. The combination of revenue over-performance and cost leverage resulted in high marginal profitability with net income of $13.5 million, an increase of 117% year over year. Adjusted EBITDA was $24.3 million, or 42% margin, and 81% higher than last year.

Our financial results are the by-product of consistent, long-term investment in innovation, our owned and operated infrastructure and operational excellence. The more value we create for customers, the more they use our platform and the stickier our relationships become. Q3 was a clear demonstration of these favorable dynamics.

REVENUE

Q3 revenue growth was strong across every region, format and channel. As Rajeev pointed out, ad dollars on our platform are primarily associated with brand advertising budgets, as opposed to direct response ad spend. In addition, iOS-based advertising is a small part of our business. Accordingly, we saw minimal impact from the elimination of Apple's IDFA as advertisers shifted ad dollars to other high ROI formats and channels on our platform.

During Q3, more than 60,000 advertisers placed ads programmatically via our platform. With the growing array of impressions and formats, we saw the number of advertisers who spent more than $1,000 increase by over 40%. This scale, and our real-time bidded marketplace delivers multiple bids per impression for our publishers' ad inventory. If an advertiser chooses not to bid, the impact to us and the publisher is limited.

Ad spend on our platform is well diversified across more than 20 verticals. Spending across every vertical, except political ads, was up double or triple digits over Q3 2020. The top 10 ad verticals, in aggregate, grew over 70% year over year.

Revenues for our mobile and omnichannel video businesses grew 64% year over year and represented approximately two-thirds of our total revenues in the quarter.

Our CTV business, inclusive of OTT, was launched in Q3 2020 and grew more than 7 times over last year. 154 publishers programmatically monetized CTV inventory in the third quarter, up from 114 publishers in Q2.

Total desktop business comprised of display and online video also performed strongly with revenue up 49% over Q3 last year.

Revenues related to Yahoo, formerly Verizon Media Group, across all formats and channels, grew more than 40% year over year and represented approximately 17% of our total revenues in the third quarter down from 28% of revenue in 2019.

Supply Path Optimization plays an important role as advertisers and agencies expand usage of our platform. In Q3 we continued to sign new SPO deals, renew existing agreements and grow our ad spending via these deals. SPO ad spend grew over 50% in line with total company revenue in the quarter.

We also continued to expand usage from existing publishers. With our land and expand strategy we added new impressions from our publishers, driving our revenue retention. The upsell of products like OpenWrap, Identity Hub and Audience Encore, expands our footprint and increases impressions from our publishers.

In Q3, we processed nearly 24 trillion impressions, more than double the amount processed for the same period last year.

We view net dollar-based retention as an important indicator of publisher satisfaction and usage of our platform. For the twelve-months-ending Q3 2021, this metric hit a high-water mark at 157%, significantly up over the comparable period a year ago. It will naturally normalize from this level once Q2 2020 results are no longer in the comparison set.

GROSS MARGIN

Our long-term strategy of owning and optimizing our infrastructure enables us to reduce our unit costs while improving customer outcomes. Importantly, as we grow and optimize our platform, the quantity of impressions we can profitably monetize continues to increase.

In Q3, we successfully reduced our cost of revenue per million impressions processed by 25% year over year.

With our focus on optimization and efficiency we achieved a 72% gross margin, our fifth consecutive quarter above 70%.

OPERATING EXPENSES

Moving onto operating expenses. In pursuit of our growth goals, we have successfully increased our global team by over 20% this year with the majority of hires in technology and go to market teams.

The combination of increased headcount for growth, incremental public company costs and stock-based compensation, resulted in operating expenses of $28.0 million, up 44% year over year. With our strong revenue growth and cost leverage, OPEX as a percent of revenue decreased by 4 percentage points from last year's level.

NET INCOME AND ADJUSTED EBITDA

Rapid revenue growth, operational efficiencies, and ongoing benefits from investments in our business resulted in GAAP net income in the third quarter of $13.5 million, or 23% of revenue, up significantly from the 16% net margin a year ago.

Q3 Diluted EPS was $0.24.

Adjusted EBITDA in Q3 was $24.3 million, or 42% of revenue, up from 35% of revenue in the prior year.

BALANCE SHEET AND CASH

Turning to our cash flow, in Q3 we generated net cash from operating activities of $26.4 million. We ended the quarter with cash, cash equivalents and marketable securities of $136.7 million, an increase of $14.7 million or 12% higher compared to Q2. Year to date we have increased our total cash by $35.8 million.

FINANCIAL OUTLOOK

Now, onto our Q4 and full year 2021 guidance.

Based on our outstanding results in Q3 and the momentum so far in Q4, we are raising our full year guidance for revenue and Adjusted EBITDA.

Anecdotally, we have heard that some advertisers may pull back spend in the fourth quarter due to concerns about the supply chain. While it is possible this may occur, there are several reasons that give us confidence for the remainder of the year.

- As significant proportion of our ad spend occurs in categories less dependent on global supply chains such as Personal Finance, Business, and Health & Fitness
- Our business is resilient to advertiser shifts because we operate a bidded marketplace.
- And as an omnichannel platform, with global scale, we have multiple drivers supporting our growth.

For Q4, we expect revenue between $74 and $76 million, or 32% to 35% year over year growth.

Keep in mind we are lapping a very strong quarter last year that benefited from one-time effects such as political ad spend.

Looking at our growth on a two-year stacked basis, that is, adding the Q4 growth from our guidance, plus the 64% growth we achieved last year, provides a clearer picture of our revenue momentum. This stacked growth translates to 95% to 99% for the fourth quarter, an acceleration from Q3's two year stacked rate of 87%.

On the cost side, we will incur new public company costs of approximately $2 million in the fourth quarter. We expect our GAAP operating expenses for Q4 to increase at a similar percentage rate as Q3's.

We expect Adjusted EBITDA in the fourth quarter to be between $28 million and $30 million, or approximately a 40% margin.

For the full year 2021, we are raising our revenue expectations by $18 million and now expect revenue between $225 and $227 million, representing 51% to 53% year over year growth. On a two-year stacked basis, our full year revenue guidance implies organic growth of approximately 83%.

In line with our significant revenue increase, we are also raising our full year Adjusted EBITDA expectations by $20 million and expect Adjusted EBITDA between $86 and $88 million or 38% to 39% margin.

We expect capex to be $27 to $30 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 Q4 gross margins may be slightly below historical Q4 margin rates, due to depreciation costs deferred from Q3 and future investment we brought forward from 2022. This effect will carryover through the first quarter of 2022.

In terms of our ad impression growth, we now expect the full year number of impressions processed in 2021 to increase by more than 80% compared to 2020.

Looking to 2022 and the revenue growth opportunities we see, we plan to aggressively hire team members and to invest in platform capacity. Additionally, we will incur incremental costs related to office reopenings and significantly higher travel and entertainment expenses as our team re-engages in person with customers around the globe.

IN CLOSING

In closing, we are very pleased with our progress in the third quarter, but we are even more excited about the opportunities ahead of us.

With four consecutive quarters of top-line organic growth over 50%, Adjusted EBITDA margins over 30% and material cash generation, we have significant momentum going into the end of the year and into 2022. Our financial results reflect the value we deliver to our customers and the strength of our usage-based business model.

The sell side of the ecosystem is rapidly consolidating, and PubMatic is well-positioned to benefit from these trends due to our global, omnichannel scale and our owned and operated infrastructure. We have a diverse set of growth drivers both in terms of publishers and buyers and a broad array of formats and channels. Based on these factors, we are confident we can achieve significant revenue growth and strong profits in the coming years.

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