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Q2 2019 Rubicon Project Inc Earnings Call

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PRESENTATION

Operator

Good afternoon and welcome to the Rubicon Second Quarter Earnings 2019 conference call. (Operator Instructions) Please note, this event is being recorded.

I would now like to turn the conference over to Nick Kormeluk. Please go ahead.

Nick Kormeluk ***The Rubicon Project, Inc. - VP of IR & Head of Global Real Estate***

Thank you, operator, and good afternoon, everyone. Welcome to Rubicon Project's Second Quarter 2019 Conference Call. As a reminder, this conference call is being recorded. Joining me on the call today are Michael Barrett, President and CEO; and David Day, our CFO. I'd like to point out that we have posted financial highlights slider to our Investor Relations website to accompany today's presentation.

Before we get started, I would like to remind you that our prepared remarks and answers to questions will include information that might be considered to be forward-looking statements, including, but not limited to, statements concerning our anticipated financial performance and strategic objectives. These statements are not guarantees of future performance. They reflect our current views with respect to future events and are based on assumptions and estimates and subject to known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from expectations or results projected or implied by forward-looking statements.

A discussion of these and other risks, uncertainties and assumptions is set forth in the company's periodic reports filed with the SEC, including our 2018 annual report on Form 10-K, the first quarter 2019 10-Q and subsequent filings. We undertake no obligation to update forward-looking statements or relevant risks.

Our commentary today will include non-GAAP financial measures. Reconciliations between GAAP and non-GAAP metrics for our reported results can be found on our earnings press release and the financial highlights deck that is posted on our Investor Relations website. At times, in response to your questions, we may offer incremental metrics to provide greater insights into the dynamics of our business. Please be advised that this additional detail may be onetime in nature, and we may or may not provide an update on the future of these metrics.

I encourage you to visit our Investor Relations website to access our press release, financial highlights deck, periodic SEC reports and webcast replay of today's call to learn more about Rubicon Project.

I will now turn over the call to you, Michael. Please go ahead.

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

Thank you, Nick. We are happy to post solid financial results in Q2 with top line year-over-year revenue growth of 32% and bottom line coming in with $4.4 million in positive adjusted EBITDA, representing a 12% margin. We are continuing to show strong financial performance with 3 quarters in a row of 30% or greater revenue growth, demonstrating our ability to increase share in the growing programmatic advertising market.

We saw a nice revenue lift in May and June that has continued into Q3, allowing us to maintain healthy future revenue growth expectations, which David will cover. This helped us to meaningfully outperform guidance we gave for Q2 and puts us in a position to deliver 2019 revenue growth solidly above our long-term annual revenue growth target of 20%.

The outperformance we experienced came largely from stabilization in CPM trends, greater than expected strength in audio and video and favorable year-over-year take rate comps. Our audio business continue to grow in the second quarter, helped by a multi-partner roadshow in Europe together with Spotify, Google and Adobe. This roadshow educated buyers about the value of programmatic audio. supply path optimization or SPO also continues to pick up momentum in the industry as evidenced in the press and media this quarter.

There is a strong need in the market for an independent omnichannel global exchange that is brand safe and highly efficient. We continue to build out our capabilities to fill that need and continue to gain momentum with the brands, agencies, DSPs and publishers. SPO is a trend that started with DSPs and has continued to be further embraced by agencies and brands and is becoming increasingly important to publishers.

Our primary current business growth drivers remain unchanged: SPO and video. In addition, the response continues to be strong for Demand Manager, the service for publishers we formally announced in Q2. SPO and vendor consolidation grabbed some headlines this quarter in the press. MediaMath, one of the largest global demand-side platforms together with us and Havas, one of the largest agencies, announced the partnership to architected the direct and transparent programmatic delivery infrastructure. Havas is quoting an ad exchanger saying they reduced their numbers supply-side partners from over 40 to around 8. This is illustrative of more buy-side partners wanting to reduce sources of supply within our ecosystem for more efficient and targeted buying. Our ability to differentiate ourselves as a scaled efficient omnichannel exchange with safe inventory puts us in a great position to continue to gain share as the industry further consolidates.

Video was a strong growth driver, and our video revenue grew 2x the industry growth rate in Q2 year-over-year. Video inventory remains in extremely high demand, and we continue to work with our publishers to bring more video to market.

Prebid's video capabilities continue to expand, which we believe will increasingly provide access to more inventory and drive additional video growth for us. We believe engagement and ROIs are very high across all forms of video, propelling significant growth and that this growth will continue for quite some time.

Our very broad video offering from CTV to desktop to mobile web and mobile app addresses all areas of growth today in the years ahead. We are also excited to bring Demand Manager to marketing in Q2 to help publishers address the challenges and complexities that header bidding introduced.

The technical complexity of managing multiple exchanges in the header requires sellers to invest significant time and resources. It adds layers of codes to the page, which erodes the end-user experience, and it makes it easier for bad actors to hide their practices.

Our solution is built on Prebid, the open-source standard that is used by hundreds of the world's largest sellers and respected across the ecosystem for its transparency and flexibility. Since launching Demand Manager in May, we are pleased with the strength of our customer pipeline joining early partners such as Publishers Clearing House, Discovery and AutoTrader. We have consistently received positive feedback from those using the service with publishers experiencing revenue gains and significant efficiency improvements. For these reasons, we remain confident that Demand Manager will be a growth driver starting in 2020.

In order to provide greater insights into the product, we will be hosting a live demo for our analysts and institutional investors in our New York office on the morning of Tuesday, September 24. Please reach out to Nick for more details.

We are pleased with the top line growth and the corresponding bottom line performance this quarter. The moves we've made over the past 2 years have put us in a position to take market share and continue to grow at a healthy rate throughout this year. We are also pleased to have the ability to continue to invest in important areas such as video, audio, mobile, Demand Manager and network efficiency to feel our future growth.

With that, I will hand things over David, who will go into greater detail regarding our Q2 financial performance.

David L. Day ***The Rubicon Project, Inc. - CFO***

Thanks, Michael. We're happy with our very strong results for Q2. We generated $37.9 million in revenue, a 32% increase year-over-year and generated adjusted EBITDA of $4.4 million. We were also cash flow positive in Q2. The year-over-year increase in revenue was once again driven by solid growth in both take rate and ad spend. Revenue exceeded our initial expectations, as May and June growth was stronger than our April trends initially indicated.

Our mobile revenue grew 42%. Our desktop revenue grew 21%, and video and audio revenue continued to drive significant growth. Operating expenses, which in our case, includes cost of revenue, for the second quarter of 2019 were $46 million, down from $48 million in the same period a year ago.

On an adjusted EBITDA basis, operating expenses, including cost of revenue, for the second quarter were slightly lower at $33.5 million versus $34.1 million in Q2 2018. This cost level reflects benefits from our cost-reduction actions during 2018, offset by investments in Demand Manager this year, in line with expectations we provided on our last call.

Net loss was $8.3 million in the second quarter of 2019 as compared to a net loss of $18 million in the second quarter of 2018. As I mentioned earlier, adjusted EBITDA was $4.4 million, which represents a 12% margin compared to an adjusted EBITDA loss of $5.5 million reported in the same period 1 year ago.

The improvements in net loss and adjusted EBITDA were driven primarily by higher revenues and measured investment. GAAP loss per share was $0.16 for the second quarter of 2019 compared to GAAP loss per share of $0.36 in the same period in 2018.

Non-GAAP loss per share in the second quarter of 2019 was $0.06 compared to non-GAAP loss per share of $0.27 reported for the same period in 2018.

Capital expenditures, including purchases of property and equipment as well as capitalized internal-use software development costs, were $4.1 million for the second quarter of 2019. We closed the second quarter with $86 million in cash, an increase of $5 million from Q1. The increase resulted primarily from the timing of receivable collections and seller payments.

Our cash and marketable security balances can swing disproportionally, both up and down, compared to the run rate of our business since we collect and pay the gross amount of flow-through to our sellers while we record revenue on a net basis. We had $300,000 of positive cash flow, excluding changes in working capital, which we calculate as adjusted EBITDA less CapEx.

I'll now share some indications for our third quarter expectations. We expect the year-over-year revenue growth for Q3 to be approximately 30%. We expect that adjusted EBITDA operating expenses in Q3, including cost of revenue, will be approximately $35 million. The increase from Q2 is primarily driven by annual compensation increases. We continue to expect that CapEx for the full year of 2019 will be in line with the prior guidance at the $20 million level, similar to 2018.

We are very pleased with our continued strong revenue growth for the quarter, expense management and with our positive cash flow. We are confident about growing share through SPO and video, and that our investment in Demand Manager will further strengthen our relationship with sellers and create long-term upside.

With that, let's open the line for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Jason Kreyer with Craig-Hallum.

Jason Michael Kreyer ***Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst***

Congrats on another strong quarter. Just starting out on Demand Manager, just a couple kind of update items since you launched it 2, 3 months ago. Can you give any thoughts on how you see that pipeline building up? What you've seen those install timeframes from going into beta to the closed beta? Any kind of updated thought process on the ROI for customers? And then perhaps, you can give, kind of, some sort of indication on what the revenue model looks like there?

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

It's a mouthful, Jason. I will -- sure, let me -- so yes. So as we kind of signaled when we talked about Demand Manager last quarter that we were going to hold of on any kind of hard projections until it started to become revenue positive or revenue producing into 2020. We remain really excited about the prospects, I think, that are time and market with Demand Manager, since we last spoke, has been very well spent, very well received. It's really validated the market need for it as we kind of had alluded to.

There's really not the competition that we're trying to unseat here. Our competition, in essence, is Prebid. Can we build an interesting-enough product that has enough benefits for our publishers that they would utilize Demand Manager, obviously, built on Prebid as opposed to running Prebid by themselves?

And I think that we're finding that it's playing out as we thought it would. That the biggest enterprise clients probably will be the longest sales cycle. And the middle tier of the upper torso are the sweet spot initially.

As far as installs, it's pretty much sticking to what we thought going in. So the cycle of installing is not radically different than what we're used to whenever we're onboard a client. So we're super excited about it. Obviously, laid on the economics of it, we're finding that, generally speaking, from a fee model, that most publishers prefer the share of media, so in other words, we just take a percentage of all of the revenue that flows through their Demand Manager.

It seems to suit their budgeting purposes as well. But we are certainly open to and are prepared to do flat-rate pricing on more of a software-service approach. And yes, we're very excited for the demo in New York. I know you've had a chance to peak at some of the tools. But I think as it becomes -- when folks see the demo, they'll understand what we're talking about and how much time it saves the publisher through things like the configuration management, how much smarter it makes them through the performance analytics tab. So yes, super excited about it.

Jason Michael Kreyer ***Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst***

Okay. Threw a lot at you, but thanks for unpacking all that. Pivoting over the supply chain announcement with MediaMath, just can you give your thoughts? Like, do you view this as a one-off type of a relationship? Or how do you expect this to evolve across the industry?

And then what does that you do for you in terms of initiating that relationship with buy-side clients? What does that give you in terms of tools and how you can go after publishers with that?

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

Yes. Great question. So I think whenever you work with largest agencies, and by that, I mean, the 5 or 6 big holding companies, they're all going to have their own flavor. Keep in mind, their's is a very competitive business as well. So they don't want to be able to tell their marketing partners or their clients, "Hey, my solution is the exact same as Publicis in Omnicom." So there's always going to be a different flavor to them. But they all have the same general thesis. And that is, the closer -- the cleaner the pipes are, the more transparent the pipes, and the closer you can get to high premium quality supply, the greater value you can add as a buyer. And generally speaking, it will drive our lower ad tax.

And so we're seeing that kind of play out with all of these discussions. I think it puts us in a great position to have one in place to be able to talk to the other major holding companies about what it could look like. It does seem to be that there will always be a business for the open market, the open auction. This centers more in my thinking around things like the private marketplace deals or the programmatic guarantee deals that are now coming to market.

So it could actually be accretive that you still have the open market business, and then more dollars that used to be transacted in digital, the traditional way, seller going in, signing an assertion order, et cetera, now gets done through these pipes because, boy, they have a cleaner line to publishers, and it's lower cost. So we're kind of excited about the fact that this could be expansive as opposed to just looking at this as, "Well, you have to take down your take rate to get the business you were getting before."

Lastly, for publishers, they're very excited, too. They had gotten separated from the traditional demand source, whether it's the market or the agency, by the DSP, by us. And anytime they can have a direct relationship with an advertiser like a Target or a Procter & Gamble, that's kind of what publishers live for. So I think the idea just bringing the dollars closer to the media is -- resonates well across the whole food chain.

Jason Michael Kreyer ***Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst***

Got it. Couple of times you mentioned, the trajectory you signed April, kind of, shifted deposit side in May and June. And I know, last quarter you give a little bit of color that CPMs have stabilized. So is that just a function of CPMs? Or is there something else baked into that comment?

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

No. I think, generally, I know that David expanded upon it. But I think like what we had cautioned when we saw the decline in CPMs, we said, "Hey, this isn't our first rodeo. We've seen this before." Sometimes a tool gets added on one side of the fence, header bidding on the supply side, and it drove up pricing because buyers weren't accustomed to it, and they got caught flat-footed.

Buyers come back with certain tools. They start to press down CPMs to try to find what the bottom might be where it's a perfect optimal solution of -- still not impairing your win rate, but getting the inventory less expensively. And what happens is when you start to -- your win rate starts to erode, you're in the business of fulfilling these budgets for marketers. You're not in the business of just buying it at the cheapest possible price, so you start to adjust your algorithms. So we kind of see this cat and mouse seesaw in a marketplace-driven world. And I think that's our best guess as to what we're seeing.

David L. Day ***The Rubicon Project, Inc. - CFO***

Yes. I think that covers it.

Jason Michael Kreyer ***Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst***

Okay. Just last one for me then. Just we're like a month into Google rolling out first-price auctions. And I know there's very limited volume over there. But just wondering have you seen any difference in the market, any different trends? Do you have any expectations on that having an impact on you?

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

No. I think we'll remain committed to our original assessment of it, and that is, the world had already moved to first price. Buyers are accustomed to it, and we don't think we'll see any kind of negative or positive impact at Rubicon.

And you are right. Although they are into the first pricing, it's just a small sliver of the AdX inventory. And I think they've now signaled that they're delaying the complete rollout for another period of time. So we haven't seen the full impact of it, but nothing that we've seen has changed our believe that this is not going to be an impact to our business.

Operator

Our next question comes from Matthew Thornton with SunTrust.

Matthew Corey Thornton ***SunTrust Robinson Humphrey, Inc., Research Division - VP***

Yes. Most of my questions, I think, have already been asked. Maybe just one on video and audio. On video, you mentioned you guys grew video about double the industrial rate, just curious kind of what the industry rate is right now?

Secondly and relatedly, video and audio, any customer concentration or your kind of key customers driving either of those buckets would be helpful to know.

And then maybe just finally coming back to Demand Manager. I don't think you hit on this, but I guess just any early findings or sense as to, number one, your customer willingness to pay for the prog, of course? And then just, if there is any other alternatives out there or fast followers or anything like that within the Prebid ecosystem? Any color there would be helpful.

David L. Day ***The Rubicon Project, Inc. - CFO***

Sure, I'll take -- so market rate on the video, I think, most -- a lot of folks peg it in the sort of 30 -- low 30s range. So yes, we've got healthy growth in video.

As far as concentration, on the audio front, we've talked about Spotify. Obviously, they're great partner. Michael talked about -- we were on the road with him in Europe in the second quarter. And so they're -- I would say they're important tent pole from an audio perspective. And I think on the video front, it's fairly distributed.

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

Yes. I think Matt, your last question was Demand Manager, competitors -- and again, what we found going to market is what we thought we'd find, and that is, Prebid is going to be our biggest competitors. So in other words, the open-sourced software that folks can download and install on their pages for free, and I do that with quotation marks, is how Prebid become so widely installed, and that's just big bonus for us because we don't have to go in and install the virtues of Prebid. The publisher already has seen it, and it works.

We just come in and say, we can make Prebid better, and it can cost you less money. So even if you're paying us directly for it, look at all the indirect cost that you're incurring. You're incurring engineering cost. You're incurring revenue cost because you're slow to change to make configurations work. And so we're saving you money by paying.

And to answer your question about response about paying for a free product, it's been Universal. Everyone understands the value, and everyone's willing to pay that we have talked to date.

So that is not the biggest pushback. The biggest pushback is amongst the largest enterprise folks, "Hey, I've got this under control. We don't see an immediate need for a paid service." But we feel as though as our product evolves as the complexity of the market place evolves and especially as things start to migrate to server, there will be many opportunities for folks to have a -- for folks to adopt Demand Manager. So we're very bullish about the prospects.

Operator

Our next question comes from Lee Krowl with B. Riley FBR.

Lee T. Krowl ***B. Riley FBR, Inc., Research Division - Associate Analyst***

First a quick housekeeping questions. I know you guys don't breakout take rate, but maybe just directionally, how it trended from Q1 to Q2, if you could?

David L. Day ***The Rubicon Project, Inc. - CFO***

Yes. We're not sort of commenting on the take rate trends throughout the year. But early in the year, we talked about expectations of the mid-13s on take rate.

Lee T. Krowl ***B. Riley FBR, Inc., Research Division - Associate Analyst***

Got it. And then I think someone asked this earlier, but I kind of wanted to take a different approach. But obviously, April to now, it seems like the clear acceleration. But I mean, I guess, overall, it seems like the industry is fairly tracking to norms. So I guess, outside of the CPM stabilization, is there any other things that perhaps cause the acceleration in May and June outside of the CPM comments you've already made?

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

So -- I'm sorry, Lee, are you talking specifically as it relates to our quarter or are you saying kind of in a macro standpoint? You're seeing a trend here, and you're trying to better understand it.

Lee T. Krowl ***B. Riley FBR, Inc., Research Division - Associate Analyst***

I'm just saying that the industry seems fairly stable, but then you guys have seen a notable acceleration per your comments. So I was just curious, if beyond the CPM, if there was any other drivers, perhaps, some unexpected market share or something along that line?

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

Well, I think we alluded to 3 specific ones for us, which should be, again, supply path optimization. No, not one holdco is like centered on us and dropped everyone else. But it's getting closer, right? We've first talked about 100 platforms going to 60, 60 to 40. You see a Havas announcing 40 to 8. And so that's going to help us. If you're a leading independent omnichannel platform, and you're looking to replace where that spend went, we're a logical choice.

And let's face it, none of the big holding companies are looking to give Google more money. And so we're a wonderful alternative to that omnichannel exchange. We also talked about video. So our video growth on our platforms outpacing in the industry by 2x, so there is another driver.

And yes, certainly, in terms of year-over-year comps, we get a good guide with the take rate. So those to me, in addition to the CPM strengthening that we alluded to, are the big drivers to the quarter.

Lee T. Krowl ***B. Riley FBR, Inc., Research Division - Associate Analyst***

Got it. That's helpful. And then just on your point about video, I believe, you -- in the press release, you guys indicated, I mean, obviously, a key addressable market for investment. Is it additional tools or capacity? Just kind of curious what exactly you guys are investing in on the video front in terms of what you need to continue to drive growth there?

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

Yes. I think video -- it's funny, people are starting to refer to it as traditional video, which is desktop video, web, mobile app video and mobile web video. So the video that we all know and love as internet consumers, digital consumers, that's still terribly complex. There's a lot of breakage. There is a -- render rates are much lower than other forms of media. There's player differences. And so you're continually mopping up the spill on aisle 3 in video. So you're throwing more engineering resources at it. You're getting smarter at it. You're building better tools. A lot of those go into Prebid. And as the leader of Prebid, a lot of our work is going into Prebid. But we're starting to see video tools thrown in from the AppNexus consortium as well.

So there is the normal blocking and tackling that always requires vigilance. And then what we would do in terms of investment on our part primarily is, the new flavor of video, which should be CTV. That carries with it some different technical challenges but a lot of business rule challenges that have to mirror the traditional linear world for it to really work. And that's primarily measurement. It's potting. It's separation. It's all sort of things that are a little bit different than running a traditional video mind business.

So yes, that's where most of the investment would go, Lee, and a lot of it's going to manifest itself into Prebid to strengthen our Demand Manager offering, which we think will be very attractive to CTV players given how restrictive they're going to be about access to this high-quality, high-demand inventory. And how they're going to source the demand primarily to themselves, so software tools that allow them to do that efficiently and at very low cost we think is going to be a greater appeal.

Operator

This concludes our question-and-answer session. I would now like to turn the conference back over to Michael Barrett for any closing remarks. Please go ahead.

Michael G. Barrett ***The Rubicon Project, Inc. - President, CEO & Director***

Yes. Thank you. So we're really happy to post the third consecutive quarter of 30% or higher revenue growth, allowing us to meaningfully outpace our long-term revenue growth target of 20% and demonstrate the leverage in our financial model.

SPO, video and seller tools are powerful growth drivers for Rubicon's short-, medium- and long-term future. We look forward to seeing many of you in September in New York, Boston, Chicago, L.A. or San Francisco as we're on the road. Thanks, again, for joining us for our Q2 results call and have a good evening.

Operator

The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.