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Q1 2019 Rubicon Project Inc Earnings Call

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CORPORATE PARTICIPANTS

David L. Day *The Rubicon Project, Inc. - CFO*
Michael G. Barrett *The Rubicon Project, Inc. - President, CEO & Director*
Nick Kormeluk *The Rubicon Project, Inc. - VP of IR & Head of Global Real Estate*

CONFERENCE CALL PARTICIPANTS

Jason Michael Kreyer *Craig-Hallum Capital Group LLC, Research Division - Senior Research Analyst*
Lee T. Krowl *B. Riley FBR, Inc., Research Division - Associate Analyst*
Matthew Corey Thornton *SunTrust Robinson Humphrey, Inc., Research Division - VP*

PRESENTATION

Operator

Good afternoon, and welcome to the Rubicon Project First Quarter Earnings Conference Call. (Operator Instructions) Please note, this event is being recorded.

I would like to now turn the conference over to Nick Kormeluk, Head of Investor Relations. 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 First Quarter 2019 Earnings 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 would like to point out that we have posted financial highlights slides 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 decks, periodic SEC reports and webcast replay of today's call to learn more about the Rubicon Project.

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

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

Thank you, Nick. We are happy to post solid financial reports in Q1 with top line year-over-year revenue growth of 30% and bottom line coming close to adjusted EBITDA breakeven. Our ability to differentiate ourselves from other exchanges has put us in a great position to gain share, and we are seeing it flow through our financial performance.

In March, we hosted our Annual U.S. Executive Exchange, an intimate, closed-door event with our top-20 buyers and sellers. It was an opportunity to get feedback from both sides about what they're looking for from one another, the challenges they're facing, and what we can do from a technology and service standpoint to meet their needs. The key desires from both sides was to find an independent omni-channel global exchange that is brand-safe, cost-efficient and able to transact all types of programmatic media. The discussion focused on streamlining the paths from buyers to sellers to make it easier for them to do business and on the need for reliable partner, such as Rubicon Project to assist them. These themes relate directly to the top-3 drivers of our business. The first 2 are fueling 2019 and beyond, namely video and supply path optimization, or SPO. The third, which we are equally if not more excited about, is that we're preparing to introduce a new offering for sellers, which we believe will meaningfully drive growth in 2020 and beyond.

Our video revenue nearly doubled again in Q1 year-over-year, demonstrating continued share gains by meaningfully outpacing the market. Video continues to be the most sought-after inventory type by buyers and sellers are struggling to meet demand. We believe video engagement and ROIs are very high across all forms of video propelling significant growth, and that this growth will continue at outsized rates for quite some time.

As a reminder, we have a very broad video offering from CTV to desktop to mobile web and mobile app. We are well positioned across all video opportunities to benefit from this trend in the short term as evidenced by Q1's growth rate plus in the intermediate and long term.

SPO also continues to be a driver of industry ad spend consolidation in 2019. We have seen in industry news and directly from our clients this quarter that buyers are actively reducing supply sources, and we believe that this will benefit the strongest exchanges, like Rubicon Project, that have differentiated themselves and offer the broadest, safest inventory with the greatest efficiency.

We've often talked about the pressure header bidding placed on buyers and the steps we've taken to mitigate those effects, such as launching EMR and acquiring nToggle. That said, header bidding has also introduced real changes on the sell side. The technical complexity of managing multiple exchanges in the header requires sellers to invest significant time and resources. It adds layers of code to the page, which erode the end-user experience, and it makes it easier for bad actors to hide their practices. Though the initial increase in revenue from header bidding largely outweighed these negatives for sellers, as CPMs have normalized and sellers have faced recent pressures on revenues, it's become clear that solving these challenges are of essential importance if programmatic is to continue to work for sellers in the long term.

In 2017, we began addressing these challenges by cofounding Prebid.org, a community that was then in the early stages of building an open-source framework for header bidding. Since then, Prebid technology has become the independent standard used by hundreds of the world's largest sellers, and it is respected across the ecosystem for its transparency and flexibility. That said, deploying and customizing Prebid to manage all demand sources is still too technically complex for sellers. To address this complexity, we've built a solution that is already being used by handful of our top clients on top of Prebid's core code, and we will share more about it very soon. As Prebid and the use of our tools continue to scale, we're confident not only that it will empower sellers to monetize more efficiently, but it will foster more efficient connections that will benefit buyers as well.

The trend towards increased privacy control and reduction of cookies in our industry continues. We are big supporters of this trend and believe this ultimately drives a healthier overall marketplace and more educated users.

During the quarter, we publicly announced our collaboration with The Trade Desk on their Universal ID. We continue to work with the DigiTrust solution, and we will be live with LiveRamp's solution soon. We believe that these tools will help significantly reduce reliance on cookies and are an important step in the eventual move to a targeted and efficient server-side cookieless world.

We mentioned several quarters ago that we began to see some industry-wide pressure on CPMs due to increased privacy and better buying pricing tools. Toward the end of the first quarter and into the second, the trend has started to slightly moderate. This will still create a modest headwind on year-over-year basis, but if the current trend remain, we may cycle a good portion of the CPM decreases by the end of the year.

We are pleased with our second consecutive quarter of solid revenue growth and the corresponding financial performance this past quarter. We believe our moves made over the past 2 years have set us up to take market share and continue to grow throughout this year. We are also pleased that the ability to continue to invest in important areas, such as video, audio, mobile, seller products and network efficiency to fuel our future growth.

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

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

Thanks, Michael. We are pleased with our solid results for Q1. We generated $32.4 million in revenue, a 30% increase year-over-year, and had an adjusted EBITDA loss of $100,000, essentially adjusted EBITDA breakeven for the first quarter, which is typically our seasonally slowest quarter. We see this as an additional milestone in our financial progress.

The year-over-year increase in revenue was driven by solid growth in both take rate and ad spend. Our mobile revenue grew 63%, our desktop revenue grew 6% and our video and audio revenue continue to drive significant growth.

Operating expenses, which, in our case, includes cost of revenue for the first quarter of 2019 were $46 million down from $53 million in the same period a year ago. On an adjusted EBITDA basis, operating expenses, including cost of revenue, for the first quarter were down 16% year-over-year to $33 million versus $39 million in Q1 2018. The decline reflects benefits from our cost reduction actions during 2018. This cost level was in line with the expectations we provided on our last call.

Net loss was $12.5 million in the first quarter of 2019 as compared to a net loss of $27.8 million in the first quarter of 2018.

As I mentioned earlier, adjusted EBITDA was essentially breakeven compared to an adjusted EBITDA loss of $14.2 million reported in the same period 1 year ago. The improvements in net loss and adjusted EBITDA were driven by higher revenues and improved cost structure as noted previously. GAAP loss per share was $0.24 for the first quarter of 2019 compared to GAAP loss per share of $0.56 in the same period in 2018. Non-GAAP loss per share in the first quarter of 2019 was $0.14 compared to non-GAAP loss per share of $0.44 reported for the same period in 2018.

Capital expenditures, including the purchases of property and equipment as well as capitalized internally used software development costs, were $2 million for the first quarter of 2019. We closed the first quarter with $81 million in cash and marketable securities, a decrease of $7 million from Q4. This reduction resulted primarily from the timing of receivable collections and seller payments and from capital expenditures.

Our cash and marketable security balances can swing disproportionally 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. Month end balances can fluctuate as a result of just a few days' delay in collection from buyers or acceleration in payment to sellers crossing month end. We had $2 million of negative cash flow, excluding changes in working capital, which we calculate as adjusted EBITDA less CapEx.

As a reminder, as of December 31, 2018, our federal NOLs were approximately $285 million, resulting in a tax-affected federal benefit calculation of $60 million, which reflects the new U.S. corporate tax rate of 21%. Our total potential tax-affected NOL benefit adding state benefits to this federal amount is approximately $75 million. We do not update these calculations on a quarterly basis.

I will now share some indications for our second quarter expectations. We expect that year-over-year revenue growth will be between 20% and 25% for Q2 2019. We expect that adjusted EBITDA will be slightly positive in Q2 2019 reflecting some additional investment related to our seller tools. We continue to expect that CapEx for the full year 2019 will be in line with prior guidance at the $20 million level similar to 2018.

We are very pleased with our continued strong revenue growth for the quarter and essentially breakeven adjusted EBITDA in a seasonally slow Q1. We're confident that our growth initiatives are helping us gain share through SPO, continued to grow video and that our investment in seller tools 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***

Michael, is there any commentary you can just provide on the broader, macro ad tech trends that you saw over the course of the quarter? If we go back to Monday, Google reported some slowdown in revenue growth. I know you did give a little bit of color on what you saw as far as CPM progression over the course of the quarter. But just wondering if there's anything else you can call out about how the quarter progressed.

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

Yes, good question. I'm kind of looking at David. Is there anything that would tie to the revenue? Of course, you did see, Twitter have a good quarter. You did see, Snap have a good quarter. So...

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

Yes, I can't think -- as Michael mentioned in his prepared remarks, we did see the downward trends in CPMs somewhat stabilize. So at least from our perspective, that was interesting development.

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

Got it. Okay. No. That makes sense. And then Michael, just kind of pushing back, you mentioned a little bit the seller tools that will probably see later this year more impact in 2020. Is there anything you can disclose about what kind of features or functionality? How specifically you can solve those pain points for publishers?

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

Jason, we're, as you know, out in the market a lot this month, and we'll be able to talk real openly about it at that point. We kind of pushed the launch of the product to a very short window from now. So in an ideal world, it would have launched -- as I said, as we talked about it, it's enclosed beta, and it's -- the coming-out party will be the official launch. So I don't want to steal too much thunder from that. But like as I said in the script, what turned out to be kind of a panacea for publishers out of the gates. When they started to do the math on how hard and technically complex running their own header solution is, even if it's Prebid, let alone, if it's someone else's wrapper, it was just a real need in the market to solve that problem and in addition because we've had a couple of years of experience of looking some of the functionality gaps to load on a bunch of functionality on top of it. So the reception has been phenomenal in market. And so, we're super delighted to talk about it in detail, but it won't be for a couple of weeks or so.

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

Okay. Sounds good. You mentioned just the industry adoption and you're kind of trying to move the industry towards cookieless auction environment. Just can you layout, what are the headwinds to that sort of broader adoption? I mean, are we still talking about match rates not where they need to be? Or are there other factors that keep a higher reliance on cookies today?

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

Yes. I think you hit the nail on the head. It's been the playbook for -- since the dawn of the Internet on desktop, right? And it's stubbornly just kind of hung around as a way that everyone is kind of synced in alignment on the sell side and the buy side. From where we sit, I think the biggest challenge/opportunity, because again, the overall tone, and I hope you've picked it up, is we think it's an incredibly positive thing for the industry and that it's good for the consumer, it's good for the user experience, and it gets us out of cookies, which just are a mess, period, end of story. But in order for this really to -- and you asked before, so what's keeping it? Like you've been saying this, everyone was saying this for years, why the heck hasn't it happened? The economics are one, right? If you were to go cold turkey right away, there's a big plummeting in value of the media. So all a buyer can do is use contextual signals that's a big decrease in CPMs. And so little by little -- and mobile apps are perfect example, right? Mobile app has never had cookies. So -- and it's a big chunk of our business. So we're pretty good at monetizing mobile app. And so there is life after the cookie, right? What I think the industry needs to do, and it's at a really perfect inflection point, is rally together for unified solution as we've stated in this call alone, we're supporting 3 initiatives and there are other initiatives out there. And we're happy to lean in and support them all on behalf of our publisher. But to be honest, in order for this to work, there has to be one solution that everyone leans into. And I think we're going to try to put a lot of muscle behind that occurring along with the rest of the ecosystem on the supply side because that feels in the solution and that's one -- it really catches fire than our (inaudible).

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

Okay. Great. Just one more for me, obligatory question on take rate and ad spend. I know you're not giving those specific numbers any more, but you did provide a little bit of color last quarter on where you expected that to trend over the course of the year. So just wondering if there's any callouts or anything, any abnormalities versus what you said a quarter ago?

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

You know, we're not really disclosing those details but as mentioned, revenue was -- growth was driven by both factors. So both are healthy.

Operator

The next question comes from Matthew Thornton with SunTrust.

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

Maybe just starting on the to-be-launched kind of publisher side tool set, can you maybe give us some color as to what the level of investment is right now that you're deploying to that? And what the trajectory there kind of needs to look like to get this off the ground? And then just relatedly, when you expect to see kind of the first dollar start to come in from some of these new products? Let me stop there. I've got a couple of others, but let me start there.

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

Yes. I think as we mentioned, we are -- we do have some incremental spend in Q2. We think that there's a really interesting opportunity here and that time is of the essence and speed-to-market is important. So we have added some modest incremental investment, and I think you'll see that throughout the rest of the year. We're not giving specific guidance as to those levels, but we think there's a really interesting opportunity here. And I think, from a top line impact, it's really a 2020 and beyond driver, although there are benefits certainly from day 1 in our relationship with our sellers and there's some soft fallout certainly from that.

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

Perfect. And there's two others, if I could. Maybe just how you're thinking about the cash balance maybe over the course of the year and by the time we exit the year? I think previously, you guys have talked about being free cash flow positive exiting this year. So any just updated color there? And then just beyond that, maybe just an update on some of the brand and agency audits that are going on out there. How those are progressing? How many are you seeing per month or per quarter or however you want to kind of quantify that? Just any update on the fallout there would be helpful.

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

Sure. Yes, on the cash front, we're excited about our being essentially adjusted EBITDA breakeven this quarter with a good trajectory headed the rest of the year. So from a cash burn perspective, this quarter, it was primarily our CapEx, and so you can kind of -- you can triangulate for the rest of the year. And from a working capital perspective, that's somewhat volatile that will kind of bounce up and down. So the cash burn rate has certainly decelerated quite significantly from prior levels.

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

And Matthew, by audit, you mean the SPO process? Is that what you meant by that?

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

Yes, exactly. Just trying to get some sense as to how many you're seeing and participating in your per month or per quarter or however you want to quantify that? The fallout you're seeing from that?

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

Yes. So the good news about SPO I think for us is that, number one from what our intelligence can provide, we're deep in the conversation with every major player, and I would say, there's a handful of large hold codes that have request for information out in terms of trying to understand their flavor of how they're going to slim down the number of partners they work with on the supply side. So I would say that it's -- the outcomes of these haven't really been determined yet. We feel good about where our position is, but that's kind of what we point to as kind of green shoots for us is that SPO at its full force hasn't come to market yet. We're seeing it on the fringes. But when it does, I think, because of all the reasons we cited, we're extraordinarily well positioned and that can add further energy to our revenue performance. Is that helpful?

Operator

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

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

Real quick, I'm sure everyone has seen the headline, but just curious what the fundamental impact of Sizmek going bankrupt in March and being sold in April had on your business?

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

Yes, sure. We had some bad debt expense related to that, but not material. For the most part, we're able to claw back those kinds of exposures from our publishers. And so, our exposure is somewhat limited. Also, I think there's some bankruptcy filings that showed relative exposure from different player. And we have pretty rigorous credit and collection processes. So we were actually less exposed than maybe some other players.

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

Got it. And then, I might have just misinterpreted it, but I thought you said you guys were seeing video share gains and so. I was just curious where those gains were coming from.

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

Well, I think the way we phrased it was our video growth rate is outpacing the industry's growth rate. I guess, that would imply share gains, and I would say probably if I had to guess, and it's a pretty murky world out there in terms of understanding where every dollar is spent on private platforms, but my guess would be our share gains are coming at the expense of general -- generalist platforms like ourselves. So we've -- as we've said before, being this omni-channel strategy of being able to represent if it can be bought or sold programmatically, you'll find it on Rubicon Project. We -- I would -- I can say with some confidence, our investment in new media formats and video was new years ago, but now it's mainstream, is paying off. And so, I think our video capabilities as a general exchange exceed the capabilities of our competitors that are generalist. Obviously, they're specialists that just specialize in video, and that wouldn't be fair I think to say that's where our gains are coming from. And I think it's coming from more of the generalist exchanges.

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

Got it. That makes sense. And then on Google, I think it was already asked, but I guess, I'll prod a little further. Just your thoughts on their -- Google's transition to outright first price auctions? And then also, yesterday, they announced by August it appears they will be switching to 100% ads.txt inventory. Curious if those impact your business or if it's strictly isolated to Google-related fundamentals?

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

Yes, great questions. And some of these things, they'll play themselves out. But we've, obviously, as an industry with us leading, have been the first-price shop for anywhere from a year to 2 years depending on when people got into it. So we have a lot of experience in first pricing. Our sellers have a lot of experience and our buyers have a lot of experience. And were there some initial disruptions when first price came online? Sure. I think it's pretty clear now that buyers overpaid on inventory because they weren't capable of adjusting their algorithms fast enough. But over the ensuing quarters, they've gotten better at it. We've provided them with tools to get them better at it. So AdX going to a first price environment is kind of just more of the same from our viewpoint. Buyers have gone through this. Sellers have gone through this. It will be hard to believe that one exchange in a unified auction could trick buyers or have buyers so unprepared that CPMs would be dramatically different. And of course, buyers have gotten so sophisticated that they know the cost of the pipes, and our take rate versus Google's take rate has been well documented. And so therefore, we think we sit in a pretty good position as it relates to them joining first price. If anything, it kind of validates all the moves we've made.

As far ads.txt is concerned, it's great. I mean, cleaning up bad actors, making sure pubs are listing their inventory, and the inventory is being resold for them, that's a formal agreement, is helpful to everybody, and I don't know what the percentage of our inventory is of ads.txt, but it's awfully, awfully high. So it's just going to be -- I think, it's great that someone like Google is enforcing it. It will force buyers to only buy ads.txt, which is exactly what the idea of the program was.

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

Got it. And then just last one. Obviously, your CapEx for the year is somewhere in the $20 million range and Q1 was in the $2 million range. So simple math would suggest there's probably a ramp at some point. Maybe just talk about the cadence through the rest of the year when you intend to kind of ramp the spend?

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

Sure, yes. And it follows a pretty historical pattern. So we typically expand 60% to 70% of our CapEx in the third and fourth quarters. So if you think about ebb and flow of our business gearing up for the high volumes in the holiday season in the fourth quarter, so should be no different this year.

Operator

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

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

Thank you. We are happy to post a couple of strong quarters, but by no means are we done growing share, delivering solid growth for shareholders in the years ahead. Our goal is sustainable long-term revenue growth of 20% or above. And it demonstrates the leverage in our financial model. SPO...

Operator

Pardon me, ladies and gentlemen, it appears we have lost connection to our speaker line.

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

Sorry about that. It would've helped if I put the mic volume on. Just in closing, we're happy to post a couple of strong growth quarters, but by no means are we done growing share and delivering solid growth for shareholders in the years ahead. Our goal is sustainable long-term revenue growth of 20% or above and to demonstrate the leverage in our financial model. SPO, video and seller products and tools are powerful growth drivers for Rubicon's short-, medium- and long-term future. We look forward to seeing many of you at the Southern California roadshow hosted by SunTrust next Monday, the Needham, SunTrust and B. Riley Conferences the week of May 20, the Craig-Hallum Conference on May 29, and the IDEA's Conference in Boston on June 12. Thank you for joining us for our Q1 results call, and have a good evening.

Operator

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